TODAY'S ECONOMICS

HAROLD S. SLOAN

Consumer Credit Institute of America, Inc.

TODAY'S ECONOMICS

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TODAY'S ECONOMICS thus emphasizes thought and minimizes the passive reading of lengthy exposition.

For a clear-cut explanation of the aims and scope of this unusual text, turn to the Preface, page v.

The student of TODAY'S ECONOMICS learns to evaluate in his own daily paper the profusion of news stories containing economic significance. He learns to use the newspaper as an important source in keeping his economic knowledge constantly up to date.

Notice particularly the interesting news stories that introduce various principles of economics. (Refer to page 57, for example.) Each news item reproduced in the text has been painstakingly selected for the purpose of focussing attention upon a specific phase of the subject.

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Today's Economics

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Today's Economics

by

Harold S. Sloan

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New Jersey State Teachers College
Montclair, New Jersey

New York
PRENTICE-HALL, INC.
1937

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Preface

THIS book presents an organized plan by which the student, through his own experiences and reasoning, is made familiar with the institutions, practices, and principles of our economic life. The approach is essentially inductive. Material is gathered from news items, short discussions, and first-hand observations. It is then analyzed and interpreted through questions and problems, which lead to definite conclusions.

No previous acquaintance with the subject is assumed. Each question can be fully and satisfactorily answered, and every problem can be correctly solved by reference to the previous conclusions reached, to the explanatory material that precedes certain of the questions and problems, and to the hints that are inserted here and there to aid in the reasoning process. For those who desire more extensive reading, page references to commonly used elementary and advanced textbooks will be found at the end of each chapter. Certain specialized works, as well as a selection of those of a more popular nature, have also been listed.

No attempt has been made to treat purely technical matters or to discuss fine distinctions having only a highly theoretical significance. The aim has been, rather, to help the student see a meaning in commonplace things, to teach and stimulate him to reason, and to guide him towards a series of conclusions embodying those fundamental facts concerning our economic life that every citizen should know and understand. For this purpose, newspaper clippings seem particularly pertinent and have been used extensively as case material. Although drawn exclusively from papers published in New York City and vicinity, these items are typical of economic news published constantly throughout the country.

It must not be imagined, however, that the material herein set forth can simply be read and at once comprehended by

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those unacquainted with the subject. This is no more possible than for a beginner casually to read a textbook in arithmetic or algebra and immediately to understand it all. Paper and pencil, persistence, and thought are required. In fact, therein lies the merit of this book if it has any. It cannot be hastily or carelessly read. The questions and problems are an integral part of the text; the student proceeds with pencil and notebook at hand and with many pauses. So attacked, economics is no more difficult than are many other subjects, if indeed, it is as difficult. On the other hand, in return for his efforts the student will, it is believed, attain a mastery of the subject and a power in economic reasoning that will lend a new joy to every newspaper, and kindle a vital interest in those baffling problems of economic life that the world is forever facing. No claim is made, therefore, for having made economics easy. It is not an easy subject. But it is claimed that by emphasizing thought and minimizing the passive reading of lengthy exposition, some measure of attainment is made more certain.

To some extent these claims have already been put to test. The manuscript, in experimental form, has for the past two years been used in the experimental high school of the New Jersey State Teachers College at Montclair, as well as in other high schools presenting widely differing conditions. The results have at least convinced the author that, when presented with challenging situations in real life, most students respond effectively to the plan of making their own observations and, with reasonable guidance, of thinking out their own conclusions. Surely there is nothing incompatible about engaging wholeheartedly in a rigorous study of the economic aspects of social life and having a good time while doing it.

The plan of this book offers a wide opportunity for individual preferences in methods of presentation. Certain topics will be found particularly well suited to socialized recitations. Field observations give a sense of reality to the whole subject and provide a wealth of material for interesting and profitable discussions. Wherever applicable, they have been suggested, and explicit directions have been given for carrying them out.

In no case, however, have they been used as a prerequisite for the understanding of subsequent material. For this reason, italic type has been used for such suggestions and directions. The problems and questions may be worked out either at home or during supervised study periods. The conclusions, in outline form, while serving to summarize the chapters, may be used to good purpose in drill periods. The various chapters are broken down into units arranged in order of difficulty. By omitting one or more units in the latter part of the chapters, the teacher may adapt the book to the slower classes. A teacher's handbook has been prepared for use with the text.

To Professor Roy W. Hatch, head of the Social Studies Department of the New Jersey State Teachers College at Montclair, N. J., I am indebted for the suggestion that I write this text, and his kindly interest and encouragement during its preparation allowed me no escape from the task of completing it.

From time to time many valuable suggestions and criticisms have come to me from various classrooms where teachers have generously coöperated in using mimeographed and lithoprinted copies of the manuscript. For such assistance, my thanks go especially to Mr. Richard B. Vastine of the Roselle Park, N. J., High School, and to Dr. John J. Cape of the Morristown School.

Mr. Jack Manley Rosé, of Summit, N. J., conceived and executed the drawings that introduce the chapters, and supervised the preparation of the charts and other illustrative material used throughout these pages. The merit of his part of the work speaks for itself.

Particularly to my students are thanks due. Not only have they uncomplainingly accepted all the limitations and inconveniences of the numerous experimental editions that I have imposed upon them, but by specifically analyzing and experimenting with the various chapters in the light of their own needs as prospective teachers of the subject, they have contributed immeasurably to whatever merit the finished product may possess. For all of its demerits and shortcomings I alone am responsible.

Permission to reprint the news items used throughout this book has been kindly granted by: The Associated Press, The Canadian Press, North American Newspaper Alliance, The United Press, Babson's Reports, Incorporated, *New York World-Telegram, The Wall Street Journal, The New York Times, Newark Evening News, The United States News, Moody's Investors Service,* and *New York Herald Tribune.*

H. S. S.

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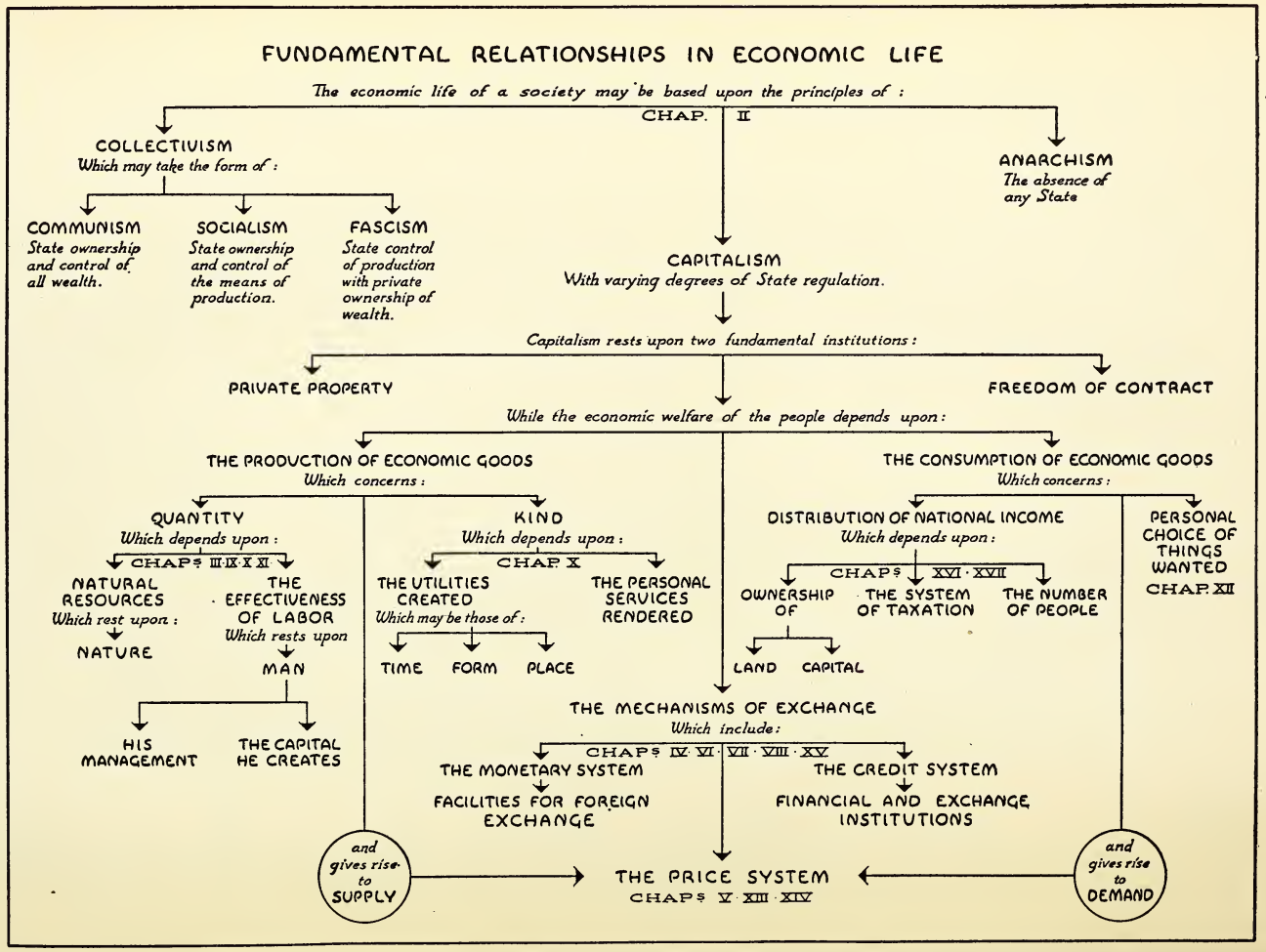
FUNDAMENTAL RELATIONSHIPS IN ECONOMIC LIFE
The economic life of a society may be based upon the principles of :
CHAP. II
COLLECTIVISM
Which may take the form of :
COMMUNISM
State ownership and control of all wealth.
SOCIALISM
State ownership and control of the means of production.
FASCISM
State control of production with private ownership of wealth.
ANARCHISM
The absence of any State
CAPITALISM
With varying degrees of State regulation.
Capitalism rests upon two fundamental institutions :
PRIVATE PROPERTY
FREEDOM OF CONTRACT
While the economic welfare of the people depends upon :
THE PRODUCTION OF ECONOMIC GOODS
Which concerns :
QUANTITY
Which depends upon :
CHAPS III·IX·X·XI
NATURAL RESOURCES
Which rest upon :
NATURE
THE EFFECTIVENESS OF LABOR
Which rests upon
MAN
HIS MANAGEMENT
THE CAPITAL HE CREATES
KIND
Which depends upon :
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Which may be those of :
TIME
FORM
PLACE
THE PERSONAL SERVICES RENDERED
THE CONSUMPTION OF ECONOMIC GOODS
Which concerns :
DISTRIBUTION OF NATIONAL INCOME
Which depends upon :
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OWNERSHIP OF
LAND
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FACILITIES FOR FOREIGN EXCHANGE
THE CREDIT SYSTEM
FINANCIAL AND EXCHANGE INSTITUTIONS
and gives rise to SUPPLY
THE PRICE SYSTEM
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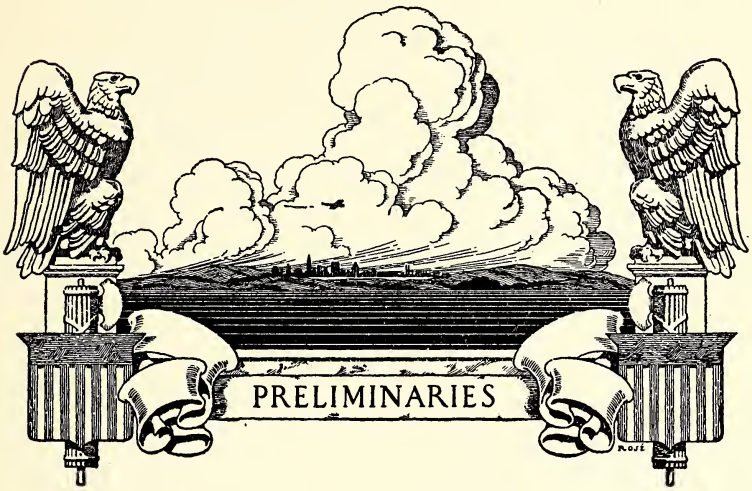
and gives rise to DEMAND

CHAPTER I



CHAPTER I

Preliminaries

EVERY day in the newspapers, in private conversations and public discussions, in activities and institutions that you can observe in your own community, interesting and significant economic material may be gathered. Our task for the next few months is to gather such material, analyze it, understand it, and formulate judgments concerning it.

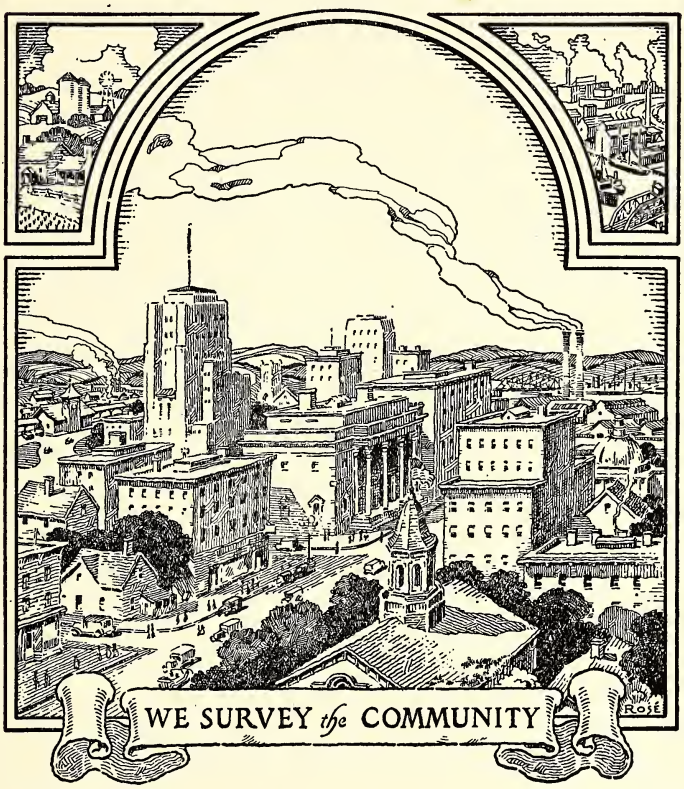
Provide yourself with a good notebook, 8½ by 11 inches, loose-leaf, and with a stiff cover. Index it according to the chapter titles used in this book. As you read, hear, or see anything concerning our economic life that interests you, make a note of the happening, or clip the newspaper and file the memorandum or the clipping in your notebook under the proper heading. As the various chapters are reached, you will have valuable contributions to make in the way of interesting opinions relating to the topics under consideration and pertinent examples of the principles being discussed.

Provide yourself, too, with seventeen large manila envelopes to hold 8½ by 11 inch sheets. Use these as files in which to keep your completed work. Your notebook, then, will not become congested. As you add new material for future use, you can dispose of the old material after it has been considered in class. By the end of the term, you will have a complete file relating to contemporary economic life. Make it so neat and attractive that you will want to keep it the rest of your lifetime.

In carrying on our work, we shall have letters to write, calls to make, materials to obtain for class exhibits, and many other details to care for from time to time. Would it not be a good plan, therefore, to organize the class as a club or association? Then the responsibilities can be divided and your own officers

can assume the management of the various activities. A glance at the field of our studies—the community—will possibly offer a suggestion for a class organization similar to the plan of organization of some of the institutions which we shall study.

CHAPTER II



CHAPTER II

We Survey the Community

UNIT 1.—THE GENERAL CHARACTER OF AMERICAN ECONOMIC LIFE

EVERY typical community has its busy corner. Start with me, then, at the "four corners," and within the radius of a few blocks we shall discover what kind of economic order it is in which we live; we shall see examples of some of the country's outstanding economic institutions and customs; then, with the results of this preliminary survey before us, we can plan our work for the next few months, and draw some immediate preliminary conclusions as well.

Observations and Discussions.

Stores of all kinds and sizes line both sides of the street. Some have "Inc." after their names, indicating a corporate form of organization **; others, we may infer, are partnerships or perhaps individual proprietorships. Every conceivable kind of commodity to fill every possible human desire seems to be offered. Here we may purchase coffee from Brazil, bananas from Central America, cocoa from Ecuador, pepper from the Malay Archipelago, and all sorts of other foreign goods ** as well as a host of manufactured articles and food products from all parts of the United States. A remarkable system indeed that brings from the four corners of the world to our very doorsteps things to suit our fancy and to make our lives more enjoyable and comfortable.

We may well wonder how it all came about. Should we inquire of some merchant—that Oriental rug dealer, for example—why he happened to come here and what led him to

** Throughout the discussion in this chapter, you will find certain passages marked with one, two, three, or four stars. This is for purposes of identification in connection with questions at the end of the chapter.

open such a shop, he would probably tell us that he thought enough people in our community would, if given the opportunity, buy enough rugs to net him a living. Knowing much about rugs, and being free under our code of laws to enter into any legitimate enterprise that he might choose, he decided to try this one, and had found his expectations fulfilled. Other merchants would, no doubt, tell us similar stories. This right to enter any vocation that one may choose and to make agreements with others in pursuit of one's interests is called the right of contract *** and is a part of the very foundation of our economic system.

As we look about us, we soon discover that the commonplace everyday economic activities of the community are beset with difficulties. Many merchants, it seems, offer the same or similar things, while each claims some point of superiority or saving in price for his particular wares. In other words, competition **** exists and engenders keen rivalry if not some antagonism among the merchants, each of whom must keep a sharp eye on his competitor's activities. Then again, we frequently hear the phrase "too high" followed by arguments aimed to convince the hesitating customers to the contrary. Most people purchase cautiously—perhaps because of the stern necessity of restricting their expenditures to sums within the limits of their budget estimates. The task of adjusting prices to buyers' pocketbooks—always a difficult one—is made doubly so by forces that constantly work to change the customer's ability to buy. These problems of competition, price adjustments,** and budgets,** we shall later study in detail.

At the particular time of our observations, the economic life of the community may be active or it may be dull. Should we linger long enough to talk with the merchants, they would tell us that, within their experience, periods of prosperity have invariably been followed by periods of depression.** Probably in the course of our conversations many theories would be advanced to explain these cycles. This is another matter that we must examine in the course of our studies.

Within the store, price tags are on display everywhere, and

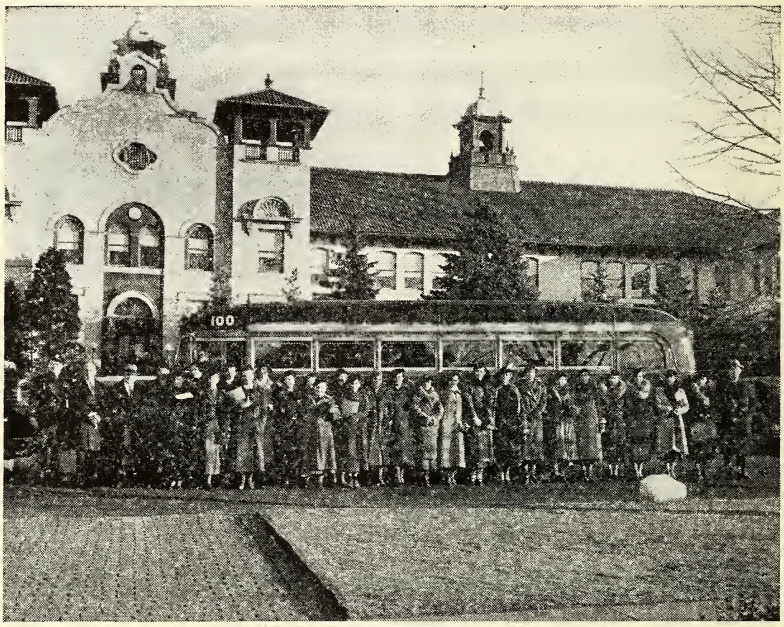
cash registers are noisily ringing up the daily sales. Indeed, were it not for the fact that we are so accustomed to the procedure, this utter dependence upon money would seem strange to us. In primitive societies, for example, the whole economic system rested upon barter, or the direct exchange of goods and services; but modern economic activity is organized and controlled in terms of money, money incomes being the goal of all individuals whether engaged in commerce, industry, or the professions.

We note, however, that although all transactions are settled in terms of a money price, the actual money is not always paid to the storekeeper immediately. When the merchant is convinced that the customer is a dependable person, he often allows him to settle for all of his purchases at certain intervals, perhaps once a month. We say, in such cases, that the customer has a charge account or is granted credit.

The economy of barter need concern us but little. It is seldom seen in modern communities except, perhaps, on the school playground where money is scarce and a top for some marbles or a jackknife for some prized foreign stamp satisfy the individuals concerned quite as much as though their wants were obtained through the medium of money. On the other hand, money ** is a subject about which there is much misunderstanding and will occupy more of our time. The system of credit so permeates our whole economic life that it can best be studied in conjunction with the activities of institutions that we shall discover presently and revisit later.

Continuing, we note that the long line of small shops is broken now and then by imposing-looking buildings. Here is one with a neat copper plate on the outside which informs us that it is the First National Bank * and a member of the Federal Reserve System.* We pause for a moment, for here is an organization that seems to serve the community in an important way. Its revolving door is kept constantly in motion by people coming and going. Inside we are impressed by the dignity of the place and by the air of quiet efficiency that pervades it. What sort of service does this institution perform that makes it such an important element in the

economic life of the community? What does membership in the Federal Reserve System signify? We overhear the term "Clearing House" * as one of the bank messengers is hurriedly dispatched to the headquarters of that organization. What is a clearing house? What has it to do with this bank? Can



Students Starting out on a Day's Tour in the Course of Which Various Economic Institutions in the Local and Nearby Communities are Visited.

we visit it? Evidently we must arrange a return visit here and apportion a considerable amount of our time to a study of these complex relationships.

For the present we gain the street and note just opposite another modern-looking building which we are told is the Savings Bank.* Why does it seem so quiet by comparison? This institution also presents possibilities for later observation and study.

A few squares distant, at a point not far removed from the main avenue, we discover the market place,* a large open square surrounded by many warehouses. Here we are told

that each morning the vociferous wranglings of the produce merchants may be heard as the vast supplies of fruits and vegetables from the countryside are bought by the local dealers. Trading here in these early morning hours, we shall find upon investigation, is fundamentally no different from the transactions on the famous New York Stock Exchange or the equally renowned Chicago Board of Trade. In due course of time we shall want to witness the proceedings, and learn exactly how the prices that we pay for our daily needs are determined.

Around the corner is a building containing the local telephone exchange.* The thought at once occurs to us that here is an institution offering a public service of a different nature from that of any of the small stores just passed; on very different terms, too, for there is no evidence of competition. Here, in fact, is a monopoly. It will be interesting to find out how prices in the case of monopolies are determined, for the conditions are not comparable with those prevailing in the early morning market. We shall want to gain an insight, too, into this great organization and the many problems of modern communication that have been successfully solved by its engineers. Perhaps we can make arrangements for the entire class to visit the Telephone Exchange.

Should we make inquiries as to who owns all of these buildings and stocks of goods that we have seen, we should be given the names of various persons and of companies which, in turn, are owned by individuals. We should conclude that the right to own private property,*** like the freedom of contract, noted in the case of the Oriental rug merchant, is characteristic of the laws of our particular community and nation. Our observations would be incomplete, however, in this general survey trip, if we concluded that all property in the community is privately owned. There just ahead of us is a lovely public park. To whom does that belong? And here on our left is the Post Office and next to it the City Hall. How about these? Evidently some property is owned collectively by all the people. The extent to which property is privately or collectively owned, as well as the existence and

extent of freedom of contract, are matters which each society determines for itself. Individuals have rights just to the extent that those rights are granted by society.

We enter the City Hall.* A bulletin board, conspicuously displayed, directs us to the various departments of the local government. There is the tax assessor's office immediately ahead of us, and the municipal treasurer's office just beyond, followed by a long row of doors leading to the headquarters of other officials. We realize that some proportion of the income of the people of the community must go to the support of the public institutions here represented, such as the schools, the health centers, the courts, the public works, the parks, and many others. There must be some plan to apportion such expenses among the people. This is an economic matter and must be included, therefore, in our list of subjects to investigate.

Some communities have a primary industry—some one commodity that is grown, manufactured, or mined in large quantities and shipped to all parts of the country or, perhaps, of the world. If it is a manufactured product, factories* can be seen here and there, ofttimes with freight cars lined up beside them ready to yield their burdens of raw materials and to carry away the finished products. If possible we must obtain permission to visit one of these factories to observe the various manufacturing operations and learn something about this kind of organization.

Clustered about the factories and in the neighborhoods not far distant are seen the homes of the workers.* The kind of houses in which they live and the degree of comforts and luxuries of life displayed in their homes will tell us something of their standard of living. This information will help us in our studies of how the wealth produced by our vast economic activities is divided among the population.

Should we continue our journey to the outlying districts we would see, no doubt, some of the more spacious and imposing-looking homes of the merchants, factory owners, and those engaged in the professions.* These, too, we shall need to consider in our studies. And beyond the city limits we

should find isolated farms * where some of the foodstuffs supplying the local market are raised. On some of the land we might see irrigation systems, tractors, and large stores of fertilizers. Such observations will later suggest some of the problems that constantly confront the farmer.

Have you noticed the remarkable amount of mutual dependence **** in our economic life that this survey of the community reveals? Those in the factories are primarily engaged in production—in converting basic raw materials into everything from flatirons to automobiles. But before these products can reach the ultimate consumer, they must be distributed through such agencies as the railways, the steamship companies, and the trucking corporations. Moreover, facilities must be provided for storing commodities already produced until they are demanded. Everybody depends upon the merchants, who are constantly at work estimating and anticipating our demands and stacking their shelves accordingly. The physicians, lawyers, teachers, and ministers depend for support upon the wealth created in the community, and they, in return, perform those professional services that are such a necessary part of every civilized community.

Building after building, public parks, bountiful stocks of commodities, factories, and machinery, and no end of other things that might be mentioned, such as automobiles, paved roads, railroads, bridges, tunnels, and the like—it is no wonder that the community can be called a wealthy one! We shall learn later on that these things are called capital goods.** Within your community there has gradually accumulated a vast amount of capital. Measured in terms of dollars it would amount to a large figure indeed. How has this been created? The answer to that question will require another detailed investigation.

1. Our survey of the community suggests two fundamental rights that are enjoyed in our economic life. (a) What are these rights? (b) Give examples from your own experience showing how these rights are exercised.

Note: See passages marked *** in the preceding pages.

2. How are these rights guaranteed?

> **Note:** See The Constitution of the United States, Article I, Section X; Amendment V.

3. How does the state enforce these rights?

> **Think:** Suppose that a person failed to fulfill his part in a contract; what would the person with whom he contracted be likely to do? How would the issue be settled? What part does police power play in the matter of private property?

4. Does the state protect people from the consequences of unwise or unfair contracts into which they may have entered?

5. Specify some ways in which these rights are limited.

> **Note:** Look up the term "eminent domain" in an unabridged dictionary.
>
> **Think:** Is it likely that a person would be allowed to use his land in the center of a residential district for a tannery? Has a person the right to construct a building on a city lot according to any plans and specifications that may please him? Is it likely that a contract entered into for the commission of a crime could be enforced? Consider the case of a contract entered into by a child who presumably does not understand the full significance of his act, a gambling contract, or a contract made by a person of unsound mind.

6. Do you think that these rights are conferred upon man by nature, or are they really privileges granted him by society?

7. Refer to the chart, "Fundamental Relationships in Economic Life," on page xii in the front of the book. (a) How would the rights under discussion be regarded in a socialist state? (b) In a communist state? (c) In a fascist state?

8. Our survey of the community suggests certain outstanding characteristics of our economic life. What are they?

> **Note:** See passages marked **** in the preceding pages.

COLLECTIVIST ERA IS SEEN IN SURVEY

In deciding what they should teach regarding economic, social and political trends, American schools should recognize that this is a transition period between a dying individualist age and a new collectivist era in economy and government, and should help the American people choose a better way of life for the future based upon a higher standard of living and greater cultural development for all.

This is the chief recommendation of the first instalment, made public yesterday, of the long-awaited report of the Social Studies Commission of the American Historical Association.

The report asserts that under collectivism American citizens are in for compulsory as well as voluntary cooperation, further growth of governmental power, greater extension of the government in business and abridgement of individual actions and property rights.

CASE 1

BAKER FOR REVISING CAPITALIST SYSTEM

Readjustment Necessary to Cure World's Ills, He Tells

Two paramount factors must be faced in solving mankind's problem, he said. "One is the sound education" of youth, not along classical lines, but with regard to the life which the youth must face when school and college days are ended. To attain this objective, Mr. Baker stated, all the processes attending upon modern education must be restudied and new systems evolved.

Secondly, he went on, there must be adult education. What is usually defined as education must be continued so that, ultimately, there may be no uneducated men and women, Mr. Baker held. There must be a continuing process of education throughout life, he declared.

"More and more world government is being influenced by public opinion," Mr. Baker said, "and it is highly desirable that the knowledge and character of our adult people be improved.

"People are learning that the most interesting and most valuable method of utilizing their increasing leisure is the continuation of their education."

CASE 2

Premier Denounces Capitalism and the League of Nations—Urges Fascism for World.

By The Associated Press.

ROME, Nov. 14.—In what was called the funeral oration of capitalism and liberal institutions, Premier Mussolini today forecast the eventual abolition of the Italian Chamber of Deputies. Speaking before the National Council of Corporations, he also advanced a program by which other nations could acquire corporative States.

CASE 3

Dictator Declares War Anew on Enemies Within Country and Demands No Compromise.

After claiming great success for the Five-Year Plan M. Stalin said it "will mobilize the revolutionary forces of the proletariat of all lands against capitalism." He argued that it had laid firm foundations for a new Socialist order in the Soviet Union.

CASE 4

The New York Times.

9. Show how these characteristics develop out of the rights discussed above.

10. Do you think that the growing complexity of our economic life increases mutual dependence, or does it simply make competition more severe?

11. Refer to Case 1. According to this viewpoint, what changes may we expect in the rights and characteristics of American economic life in the future?

12. Refer to Case 2. How would Mr. Baker bring about a revision in the capitalist system? Discuss.

13. Refer to Case 3. What is Mussolini's prediction for the capitalist system? Discuss.

14. Refer to Case 4. How would Stalin bring about economic change? Discuss.

15. Prepare in your notebook a four columnar table such as the one shown in the accompanying illustration.

A WORK PLAN *for the* STUDY OF AMERICAN ECONOMIC LIFE				
	Places that can be visited:		*Chapter*	
	Text suggestions:	*Local institutions:*	*N°*	*Title*
1				
2				
3				
10				
11				
	Other matters to be investigated			
	Text suggestions			
1				
2				
7				

In "A Survey of the Community," ten different places or institutions are suggested for observation and study (marked *). If a Federal reserve bank or a branch Federal reserve bank is nearby, this should be included and will make eleven. Using the upper part of the tabulation, name in the first column these places and institutions suggested in the text. For each item thus noted, name in the second column the nearest local institution or address that might be visited.

Besides suggesting certain places and institutions, seven

general subjects of particular economic significance are mentioned (marked **). In the lower part of the table, list these subjects in the first column.

In the third and fourth columns, list the numbers and the titles of the chapters in the text that correspond with the places to be visited and the other subjects to be studied.

Conclusions.

A. In this chapter you have learned about certain rights and characteristics of American economic life.

1. What are these rights?
   (a) How are they granted?
   (b) How are they enforced?
   (c) How are they limited?
2. Are these rights "natural," or are they "societal"?
   (a) Which of these rights is greatly restricted in a fascist state?
   (b) Which of these rights is greatly restricted in a socialist state?
3. What characteristics of a capitalist system grow out of these rights?
4. What changes are predicted for the capitalist system?
   (a) By the socialists?
   (b) By the fascists?
   (c) By those who would adhere to democratic principles?

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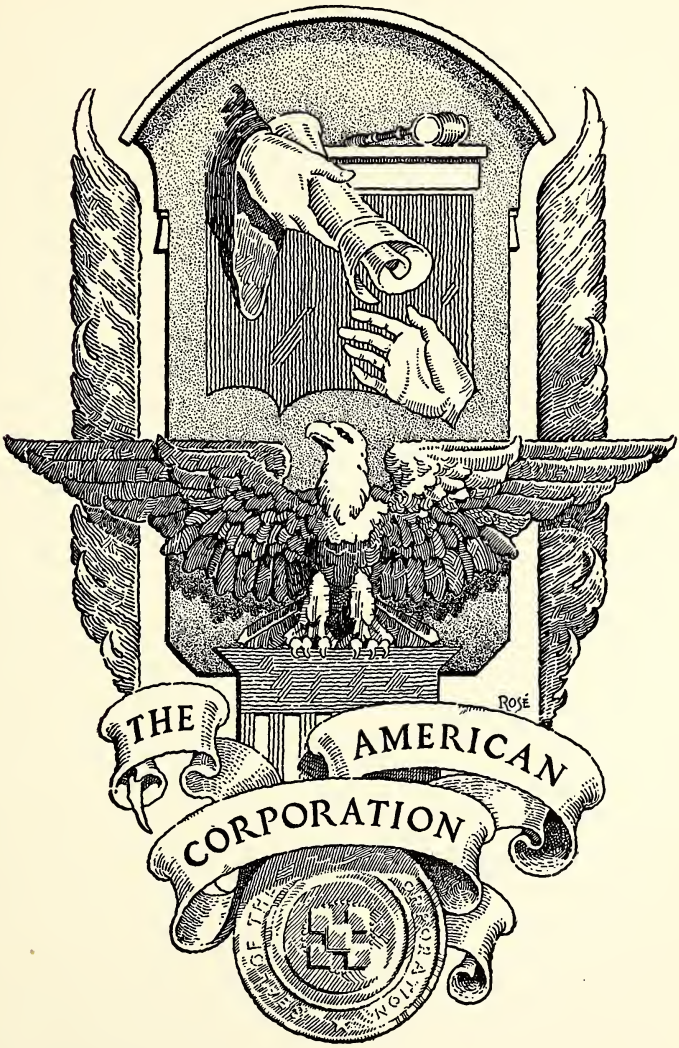
CHAPTER III



CHAPTER III

The American Corporation

UNIT 1.—THE CORPORATE FORM OF ORGANIZATION

Observations and Discussions.

In the course of our survey of the economic life of the community, we observed both large and small industrial units, and we noted the use made of the *corporate form of organization.* Throughout the country as a whole there has been a definite trend during recent decades in the matter both of the size of business enterprises and of the manner of their organization. Our first investigation aims to discover this trend and the reasons for it.

1. Prepare a chart such as the one shown in the sketch appearing on page 23.

Refer to the statistics on page 22. Point off on the first bar under the title "Establishments" 23 spaces (one hundredths), indicating the percentage of corporations in 1904. Point off 53 spaces, indicating the percentage of proprietorships in 1904. Point off 24 spaces, the remaining part of the bar, indicating the percentage of all other types of establishments in 1904. Color these three divisions contrasting shades pleasing to the eye. Directly above the first division, letter in the title "Corporations." Over the second division, letter in the title "Proprietorships," and directly over the third division letter in the title "Other Establishments." Divide the other three bars according to the statistics, using the same color scheme. Place the percentages inside of the bars in the proper divisions. In a similar way and using the same color scheme, plot the statistics for wage earners and the value of products.

In each of the three divisions—establishments, wage earners, and value of products—a comparison of the corporation sections of the bars with the sections indicating individual and other types of organizations will reveal certain significant changes that have taken place in the type and size of industrial establishments from 1904 to 1919.

TYPES OF INDUSTRIAL ESTABLISHMENTS, NUMBER OF WAGE EARNERS EMPLOYED, AND VALUE OF PRODUCTS, 1904–1919

	1904	*Per Cent*	*1909*	*Per Cent*	*1914*	*Per Cent*	*1919*	*Per Cent*
Establishments: [1]								
Total	216,180	100	268,491	100	275,791	100	290,105	100
Corporate	51,097	23	69,501	26	78,152	28	91,517	31
Individual	113,946	53	140,605	52	142,436	52	138,112	48
Other	51,137	24	58,385	22	55,203	20	60,476	21
Wage earners:								
Total	5,468,383	100	6,615,046	100	7,036,247	100	9,096,372	100
Corporate	3,862,698	71	5,002,393	76	5,649,891	80	7,875,132	86
Individual	755,923	14	804,883	12	707,568	10	623,469	07
Other	849,762	15	807,770	12	678,788	10	597,771	07
Value of products:								
Total	$14,793,902,563	100	$20,672,051,870	100	$24,246,434,724	100	$62,418,078,773	100
Corporate	10,904,069,307	74	16,341,116,634	79	20,183,147,103	83	54,744,392,855	88
Individual	1,702,830,624	11	2,042,061,500	10	1,925,518,298	08	3,536,321,836	06
Other	2,187,002,632	15	2,288,873,736	11	2,137,769,323	09	4,137,364,082	06

[1] *Abstract of the 14th United States Census of Manufactures,* p. 1021.

CHANGES IN TYPE OF INDUSTRIAL ORGANIZATION	
ESTABLISHMENTS	
1904	
1909	
1914	
1919	
WAGE EARNERS	
1904	
1909	
1914	
1919	
VALUE OF PRODUCTS	
1904	
1909	
1914	
1919	

2. Refer to the above figures and the chart just compiled. During the period shown on the chart (a) how did the rate of growth in the total number of corporations compare with the rate of growth in the number of other forms of business organization? (b) How did the growth in the number of wage earners employed by corporations compare with the change in the number of wage earners employed by other forms of business organization? (c) How did the rate of growth in the number of corporations compare with the rate of growth in the number of wage earners employed by corporations? (d) What does this signify as to the change that occurred in the size

of corporations? (e) How did the rate of increase in the value of the products produced by corporations compare with the rate of increase in the value of products produced by other forms of business organization? (f) How did the rate of increase in the value of the products produced by corporations compare with the rate of growth in the total number of corporations? Does this confirm or refute your answer to (d) above?

3. Refer to Case 5. (a) What reason does Mr. Roberts give for the steady trend towards large industrial units? (b) Mention some ways in which large industrial units may effect savings in costs.

> **Think:** Is there any advantage in buying in large quantities? How about the cost of selling the product—expenses of traveling salesmen, for example? In the matter of management, is it possible for one competent man or a group of competent men to enlarge the scope of their activities with little or no additional cost?

To understand why the corporate form of organization has become more and more popular as industrial units have increased in size, it is necessary to know something about how a corporation is formed. This suggests an opportunity. In arranging for our community observations and our class programs, we shall have letters to write, calls to make, materials to collect for class exhibits, and many other details to care for from time to time. Would it not be a good plan, therefore, to organize the class as a club or association? The responsibilities can then be divided and the class members themselves can assume the management of the various activities. If the class desires to do so, the club can be organized as a corporation.

At the outset it is well to observe that there are a number of types of corporate organizations, such as banking corporations, railroad corporations, water supply companies, cemetery corporations or associations, coöperative societies among working men, agricultural coöperative associations, navigation companies, and others designed for some special business or purpose. The regular business corporations are probably familiar to most people; corporations not for pecuniary profit,

however, such as religious societies and clubs, are not so well known.

Each type or class of corporation is governed or controlled by certain state laws or statutes which apply only to that class

BANKER SEES END OF SMALL INDUSTRY

Great Corporations Owned by Employes and Stockholders Predicted by G. E. Roberts.

SAYS SOCIETY WILL BENEFIT

Ownership of great corporations by employes and by the people they serve will supersede the old system of ownership by individuals of a multitude of small industries, said George E. Roberts, vice president of the National City Bank, yesterday at the meeting of the American Institute of Mining and Metallurgical Engineers in the Engineers Building, 29 West Thirty-ninth Street. The competitive conditions which exist in modern industry, he said, and which supply the greatest stimulus to industrial progress by the constant pressure toward lower costs, have caused a steady trend to larger industrial units under one general management.

CASE 5 *The New York Times*

and do not relate to or control any other type of corporate organization. Laws are enacted providing that business corporations, for example, must have a minimum of money with which to begin business, whereas corporations not for pecuniary profit are not so restricted. Corporation laws differ among the various states, but the general principles underlying such

laws are the same everywhere. The plan outlined in this chapter follows the practice in the State of New Jersey.

Suppose, then, that we consider ourselves a group of incorporators meeting for the purpose of forming a corporation. Obviously, the corporation should be organized not for pecuniary profit.

The first thing to do is to appoint a temporary chairman of the meeting and a temporary secretary. Then, upon a motion, duly made, seconded, and carried, that the class organize as a club corporation not for pecuniary profit, the following agreement is signed by each incorporator.

AGREEMENT TO INCORPORATE
as a
CLUB, NOT FOR PECUNIARY PROFIT

We, the undersigned, hereby agree, each with the others and with the incorporation hereinafter to be organized, severally and not jointly each to become a member of such corporation.

The corporation is to be organized as one Not for Pecuniary Profit, under the laws of the State of ....., the name to be hereafter selected by the undersigned, subject to proper state approval.

The purpose for which the corporation is to be formed is to facilitate the study of economics and pursue field studies and investigations thereof in ..... and neighboring communities.

Signatures	Addresses
.....	.....
.....	.....

After we have agreed to incorporate, the next step is to select a name. The name is subject to approval by the state in order to prevent two organizations existing under the same name. In our case, however, we dispense with this approval and assume that the name selected has proper sanction.

Generally speaking, a corporation depends for its powers and rights upon (1) a Certificate of Incorporation, and (2) By-laws, limited, of course, by statutes. The next step, then, is to draw up a certificate of incorporation.

Under the laws of New Jersey five or more persons may execute such a certificate. The certificate or charter, as it is

often termed, must set forth: (1) the name of the corporation, (2) the purpose for which it is formed, (3) the place where it is to be located, (4) the number of trustees, which must be at least three, and (5) the names of the trustees at the time of organization. The following Certificate of Incorporation may be used as a guide, and the spaces may be filled in as the incorporators determine. The most important matter to be decided at this time is the choice of a Board of Trustees.

CERTIFICATE OF INCORPORATION
OF THE
.....
(Here state the name of the club)

THIS IS TO CERTIFY that the undersigned do hereby associate themselves into a corporation under and by virtue of an act of the State of New Jersey, entitled "An act to incorporate associations not for pecuniary profit," approved April 21, 1898, and the several acts supplementary thereto and amendatory thereof.

FIRST. The name of the corporation is .....

SECOND. The purposes for which this corporation is formed are:

1. To pursue, as a class or group, in an orderly, systematic, and efficient manner, the study of economics.
2. To study the several economic institutions in the local and near-by communities and to make field trips and investigations in the course of such studies.
3. To hold meetings for the discussion of the studies made from time to time.
4. To enter into agreements necessary to facilitate the studies and conduct of the field trips and investigations.
5. To issue a membership card to each member of the corporation.

THIRD. The location of the principal office of this corporation is at ....., County of .....

FOURTH. The number of trustees of this corporation is.....

FIFTH. The names of the trustees selected for the first ..... of the existence of this corporation are:

Signatures	Addresses
.....	.....
.....	.....
.....	.....
.....	.....

SIXTH. The period of existence of this corporation is for .....

IN WITNESS WHEREOF, we have hereunto set our hands and seals this ..... day of ....., 19..

.....
.....
.....

Signed, Sealed and Delivered
in the presence of

This certificate in duplicate would now ordinarily be sent to the County Clerk of the County in which the principal office of the corporation is located. The Clerk would stamp upon the original certificate the date of filing and return it, and would retain the duplicate for his own records. The original would then be sent to the Secretary of State, who would file it in his office. The corporation comes into existence on the date that the original certificate is thus filed. For our purpose, this procedure may be omitted, and we may assume that the corporation is now in existence.

The final business before the meeting of the incorporators is the adoption of by-laws. The following may be used as a guide and the spaces filled in as may be determined:

BY-LAWS
OF
.....
(Name of Corporation)

ARTICLE I

The name of the corporation shall be .....

ARTICLE II

The purposes for which the corporation is organized are those stated in the charter, reference to which is hereby made.

ARTICLE III

1. *Membership*—Any person enrolled as a member of the class taking the course known and designated as ..... in the curricula of ..... School shall be eligible to membership in this organization or club.

2. *Membership Card*—The Secretary shall issue a card to each member which shall be substantially in the following form:

.....
(Name of Club or Organization)

No. ..... Dated ....., 19..

.....
(Name of member)

is entitled to all the rights and privileges of a member in good standing.

.....
Secretary

ARTICLE IV

Meetings—Regular meetings of the members shall be held at the registered office of the corporation ..... in Room ..... at ..... o'clock, or at such other place and time as may be fixed by the members, for the purpose of transacting such business as may properly come before the meeting and for carrying on the studies for which this club is organized.

ARTICLE V

Quorum—Attendance by ..... members shall constitute a quorum for any meeting. No business shall be transacted in the absence of a quorum.

ARTICLE VI

1. *Voting*—At each meeting of the club members, each member present and in good standing shall be entitled to one vote. No voting by proxy shall be valid.

All voting at any election of Trustees shall be by ballot, but votes upon other questions upon which a meeting is asked to pass may be *viva voce*[2] unless a majority of the members present shall demand a vote by ballot.

2. *Trustees*—Each Trustee shall have one vote upon any matter coming before a meeting of the Board of Trustees requiring a vote. Voting shall be *viva voce*.

3. *Recording*—The results of all voting at any meeting shall be properly recorded in the minutes of the meeting at which action was taken.

ARTICLE VII

Order of Business—Order of Business at any club members' or Trustees' meeting shall be such as shall be fixed by the presiding

[2] *Viva voce* means "by the spoken word." In a *viva voce* vote the chairman first states the question on which a vote is to be taken, then he asks all those who agree to say "aye." Following this affirmative vote, the chairman asks all those who disagree to say "no."

officer, but by a majority vote of the members present at any meeting, the order may be changed.

In general, parliamentary rules shall be followed.

ARTICLE VIII

1. *Trustees*—At the organization meeting of the club, the members shall elect ..... of their number who shall constitute the Board of Trustees for the ensuing year or until their successors shall be appointed and shall accept the office as a member of such board.

2. The Board of Trustees shall as soon as possible after the organization meeting of the members of the club hold their organization meeting at which they shall elect officers from among their number, authorize the secretary to issue membership cards, and transact any other business pertinent to the organization of the Board of Trustees.

3. Any trustee may be removed from office for misconduct in office by the vote of a majority of the whole board at any meeting of the Board of Trustees.

4. In case a vacancy arises, the majority of the remaining members of the Board of Trustees shall have the power to appoint a successor from the membership of the club to fill the unexpired term of said trustee ceasing to be a member of the board.

5. The Board of Trustees shall have the power and authority to arrange for field trips, and other activities of the club; to make rules and regulations for the orderly and systematic conduct of the club's activities, to delegate authority, and do all things necessary to advance the studies and to carry out the purposes for which the club is organized.

ARTICLE IX

Officers

Number and Election—The Executive Officers of the corporation shall be a President, Vice-President, Secretary, and Treasurer; who shall be elected by a majority vote of the Trustees. Each Executive Officer shall hold office during the period for which the Trustees are elected.

President—The President shall be the chief Executive Officer of the corporation and shall preside at all meetings of the club members and Trustees. Subject to control of the Board of Trustees he shall have general charge of the affairs of the corporation.

Vice-President—In the case of the absence or the disability of the President, the duties of the office shall be performed by the Vice-President, but the Board of Trustees may assign to him such other duties as they may from time to time deem necessary.

Treasurer—The Treasurer shall have the custody of all the funds of the corporation and shall deposit the same to the credit

of the corporation in the school bank or such other depository as the Board of Trustees may designate. When required by the Board of Trustees, he shall render a statement of his cash accounts and shall enter regularly in the books of the corporation to be kept for that purpose full and accurate account of all moneys received and paid by him on account of the corporation.

Secretary—The Secretary shall keep the minutes of all meetings of the Board of Trustees and the Club members, and shall have custody over all papers submitted by the Club Members and shall keep an accurate record of such in a book for that purpose.

ARTICLE X

Amendments

The members of the club shall have the power to alter and amend these by-laws by a vote of the majority of all club members present at any regular meeting.

As provided in the by-laws, as soon as convenient after the incorporators' meeting, the Board of Trustees should hold a meeting and elect from their numbers the officers of the corporation.

Corporations in General.

You have just formed a non-profit-making corporation. To organize a corporation for pecuniary profit, you would proceed in much the same way. Instead of issuing membership cards, however, you would issue stock certificates. You would ordinarily first determine upon a certain value for the stock, called the par value, and then issue shares to each member according to the amount of his investment in the company. If, for example, $100.00 per share were determined as the par value, then a member who invested $1,000 would receive ten shares, and likewise a member who invested $10,000 would receive one hundred shares. This is a very important matter because it is usually provided that each stockholder shall have one vote for each share of stock held. The greater the investment, therefore, the more the votes; and if one person owns as much as fifty-one per cent of the stock, that person will control the management of the corporation, for his votes will constitute a majority, and hence will determine who the trustees—or

directors, as they are called in a profit-making corporation—shall be.

Numerous variations occur in the manner of issuing capital stock and in the matter of rights and privileges conferred by it. Large, well-known corporations whose stock is sold in nation-wide or even world-wide markets frequently do not specify any par value on some of their capital stock. So far as the investing public is concerned, the worth of the stock depends not at all upon its par value, but rather upon the safety of the investment and its possibilities for earning dividends. For this reason many corporations specify merely the total number of shares issued and leave prospective investors to determine for themselves the safety of the investment, its earning power, and its possibilities by studying the published financial statements of the corporation. These matters will be considered in more detail later. For the present it is the structure of a profit-making corporation with which we are concerned.

If you were organizing a corporation for gainful purposes, you might find it of advantage to issue different classes of capital stock. Two classes are commonly designated: preferred stock and common stock. Preferred stock is usually "preferred" in the matter of both dividends (earnings) and principal (the money invested). This means that the holders of this class of stock are entitled to receive and are guaranteed dividends of a certain stipulated amount before any earnings are allotted to the common stockholders, and, in the event that the corporation is dissolved, are entitled to a priority claim upon such property of the corporation as remains after all debts are paid. The common stockholders receive all the distributed earnings of the corporation after the specified amounts guaranteed to the preferred stockholders are paid. If the corporation is dissolved, all property remaining after the debts are paid and after the claims of the preferred stockholders are satisfied is distributed among the common stockholders. Preferred stock, therefore, appeals to the conservative investor, for, although his profits are limited, his risks are less. Common stock, on the other hand, imposes greater risks, but at the same time offers greater opportunity for

profit. It must always be kept in mind, however, that all stockholders of whatever class are basically partners in an enterprise; dividends depend upon the earnings of the corporation, and the safety of the principal depends upon the ability of the management to conserve and to augment the property of the corporation. The responsibility for management rests ultimately upon the stockholders, the actual owners, and the proprietors.

4. Make a list of the steps necessary to the formation of a corporation.

5. By means of a chart and a brief explanation accompanying it, show the nature of the corporate form of industrial organization.

6. An industrialist wishes to organize a corporation with a paid-in capital of $100,000. Determine for him a consistent par value for the stock and the number of shares of stock that would be issued.

7. A corporation ready to discontinue business has converted all of its property into $10,000 in cash. It owes the bank $5,000, it owes, various merchants $3,000, and it has 1,000 shares of stock outstanding at a par value of $10 a share. Will anybody lose in this transaction? If so, who will lose and how much?

8. Do you think that a corporation is organized according to democratic principles? Why, or why not?

UNIT 2.—ADVANTAGES, DISADVANTAGES, AND ABUSES OF THE CORPORATE FORM OF ORGANIZATION

Observations and Discussions.

Now that we have learned something about the way a corporation is formed by organizing our own, it is easy to see why this form of business organization has become so popular. Its advantages are many. In the first place, it provides a convenient arrangement by which a number of investors may pool their savings and receive proportionate shares in the earnings. Purchases of shares of stock may be made to the extent desired; earnings set aside by the directors for distribution as dividends can easily be divided by the total number of shares outstanding and a definite sum be assigned to each share. Then again, the continuance of the enterprise is not

endangered by the death of a part owner. If a shareholder dies, his stock simply passes on to his heirs, who may retain it if they wish, or who may sell it if they deem wise and if they can find a purchaser. In any event, the corporation is not involved in the matter. Likewise, changes in ownership of the organization can readily take place. This is accomplished by the sale and purchase of shares of stock. Indeed, simply to record the daily changes in ownership of our large corporations is a clerical task of no small magnitude. Finally, perhaps the most important advantage of the corporate form of organization is the *limited liability* feature. In most cases a stockholder cannot lose more than his total investment in the undertaking. This means that even if a corporation cannot meet its debts, no stockholder is responsible for more than his original investment. In some states this rule has been modified to some extent, but it is still generally true that stockholders enjoy some degree of advantage in this respect.

No other form of business organization offers such advantages. The *proprietorship,* in which one individual owns and controls an entire enterprise, offers the advantage of simplicity, but is obviously not suited to large-scale undertakings requiring more capital than any one person is able to contribute. A *partnership* is an organization of two or more persons associated in a company according to the terms specified in a contract. Sometimes certain legal advantages are gained by this type of organization; for example, individuals associated together in this way for the purpose of conducting a banking business are frequently not subjected to the rigid regulations imposed upon incorporated banks. However, the relationships, being of a contractual nature, terminate upon death. Consequently, the interests of a deceased partner may be withdrawn, and the enterprise may thereby be deprived of needed capital. Furthermore, according to the laws of most states, each partner is liable personally for the debts of the company, even though such debts may have been contracted by another partner. This disadvantage, perhaps more than any other, has discouraged the formation of partnerships.

On the other hand, the corporate form of business organiza-

tion is not without its disadvantages also. The limited liability feature sometimes makes it difficult to obtain a much-needed loan—how difficult depends, of course, upon the financial standing of the organization, together with the character of its directors and officers. The fact, however, that in the case of a corporation no individual actually pledges his entire worth for the repayment of the loan makes a difference. Then again should be noted the fact that minority stockholders may become dissatisfied at finding themselves outvoted by a few individuals holding large blocks of stock. No doubt many injustices have been committed in this way, although it must be said that so far as the law is concerned minority stockholders are not without considerable protection. Finally, most states levy a tax on the authorized capital of corporations.

1. (a) Prepare a table setting forth the advantages and the disadvantages of the corporate form of organization. (b) Compare these advantages and disadvantages with the other forms of business organizations.

2. Refer to Case 6 (page 37). What advantages of the corporate form of business organization make the conditions cited by Mr. Houston possible?

3. A corporation has four stockholders and 2,000 shares of stock outstanding—that is, owned by stockholders. A owns 1,000 shares; B, 500 shares; C, 300 shares; and D, 200 shares. $6,000 in earnings is set aside by the directors for distribution as dividends. How much will each stockholder receive?

The very advantages of the corporate form of organization have made certain abuses of it possible. Stock ownership implies the assumption of a share in the responsibilities of management, but shareholders are reluctant to shoulder this burden. It is not surprising, therefore, to find instances of mismanagement. The privilege of limited liability opens the way of avoiding personal risk while reaching out for questionable gains. Then again, it has been found possible so to manipulate different classes of stock that a large body of shareholders are deprived of the opportunity of expressing approval or disapproval of the management even if they feel disposed to do so. Finally, the very impersonal nature of a corporation and the remoteness of the shareholders from the

everyday conduct of its affairs lend a certain tolerance to the acts of a corporation that is not felt in the personal relationships among individuals.

4. Refer to Case 7. In the light of Mr. Dame's experience, explain how the following conditions, cited by I. Maurice Wormser in *Frankenstein Incorporated,* pp. 115–117, might occur:

> "In one recent instance the bonus system, as originally operated, provided that certain executive officers of the company were to receive each year, in addition to their salaries, a maximum payment of 8 per cent of the net profits. . . . During the years 1925, 1926, 1927 and 1928 . . . the executives' bonus approximated nearly $7,000,000. In fourteen years, $36,000,000 was paid out in bonuses to a handful of officers. The president averaged over $814,000 per year bonus, besides his salary, during the thirteen years previous to litigation. In 1929 his salary was $12,000 and his bonus was $1,623,753. In 1930 he received the same salary plus a bonus of $1,015,591. In a number of other years the amount of his bonus was over $1,000,000. Several other executive officers received, in addition to their yearly compensation, a bonus of from $200,000 to $375,000 apiece during several years. Up to the year 1928 about twenty officers received some $31,000,000 in bonus payments. Five or six were paid the bulk."

5. On page 98 of the same book Mr. Wormser cites the following:

> "After a recent bank failure in the City of New York, the largest which has ever occurred in the history of banking in this country, the head of the bank's legal department declared on the witness stand, under examination by his attorney, that there were always some 'nominal corporations' on hand in his office for use in business transactions and in taking title to properties; that, on one occasion, an associate asked him for two such corporations, and he 'gave' him two of these, which subsequently figured in an $8,000,000 deal, without asking for what the corporations were wanted."

(a) Why should anyone want to "borrow" corporations—why not carry on the same transactions in one's own personal name?
(b) What particular privilege of the corporate form of organization was abused in the above example?

6. Refer to Case 8. A number of states allow corporations to issue what is called non-voting stock; that is, stock that participates in the profits of the corporation, but which does not give the owners the right to vote, not even upon the most vital issues. (a) Explain the abuses that ensue according to Professor Ripley. (b) If the experience cited by Mr. Dame is representative of conditions in general, is there any objection to non-voting stock? Discuss.

BANKERS' CONTROL OF TRADE DEPLORED

Prof. Ripley Warns of Trend to Stock Ownership Divorced From Responsibility.

POWER IN A FEW HANDS

In a paper which stirred the assembly at the Hotel Astor, Professor Ripley said the fundamental changes since the war have been "the alarming divorce of the ownership of property, represented by securities emitted by corporations or trustees, from any direct accountability whatsoever for its prudent and efficient management" and "the wide and ever accelerating diffusion of a considerable portion of this ownership, represented by stock holdings of employes and of the directly consuming public."

The net result of these changes, he said, "is the assumption of an irresponsible control by intermediaries—most commonly bankers, so-called—in place of the former responsibility for direction which, theoretically at least, rested upon the shoulders of the actual owners."

Cites Financial Instances

"The recent Dodge Motors Company is typical. A banking house buys up a private business for, let us say, $146,000,000. This sum and more they recover, let us say, by the sale to the public for $100,000,000 of bonds, preferred stock and 1,500,000 non-voting shares of Class A common stock. But not a single one of the 500,000 Class B voting common shares are thus sold. The promoters have virtually paid themselves a handsome profit for the assumption of the entire directorial power, having mortgaged the property to the full amount of its original cost, including both assets and capitalized earning power."

FINDS BIG BUSINESS NO LONGER FEARED

Houston Sees Corporations Now as Real Allies of the Masses.

SPEAKS TO ELECTRIC MEN

Changes in Business Control

"Before 1900 when the hectic discussion of trusts raged, big business in the main had restricted ownership or control—in many cases, family ownership," he said. "The picture has radically and rapidly changed. Today, ten retail trades where one would expect restricted ownership have 41,000 stockholders. Two packing companies who had family ownership have now 126,000. The Pennsylvania Railroad, 140,000; Steel Corporation, 146,000; Standard Oil groups, 300,000; American Telephone and Telegraph, over 400,000 common stockholders and nearly 200,000 preferred stockholders in its associated companies; Class 1 railroads, 750,000; public utilities, between three and four million; insurance companies, 50,000,000.

"It is interesting to note that the big corporations, formerly regarded as menacing to the masses, have become the channel through which the small investor has been furnished an easier opportunity to become a capitalist. In larger measure and more rapidly than any one thought possible, laborers are investing and becoming capitalists. In such manner the real solution to the relation of labor to capital is being effected."

CASE 8

WANTS PROXIES HURRIED.

F. L. Dame Assails Indifference of Stockholders.

There should be some way to prevent indifferent stockholders from impeding proposed corporate changes, it was said yesterday by Frank L. Dame, president of the North American Company.

CASE 7

CASE 6

"My experience in the last few weeks in endeavoring to obtain proxies from North American stockholders in order to change our capital structure leads me to believe that the average stockholder has little inclination to take part in the direction of his company," said Mr. Dame. "Had there been disapproval of the proposals, I could have understood this indifference, but there was not. We eventually received proxies representing 79 per cent of the common stock and 77 per cent of the preferred stock."

The New York Times.

7. Discuss the following observation made by Mr. Wormser in the book cited above, pp. 100–101:

> "There can be no doubt that men united into a corporate group will do things corporately and collectively which individually they would not think of doing. . . . Buying members of the government, corrupting judges, subsidizing lecturers and teachers, fixing juries, and similar sins forbidden by the decalogue of common decency, are not unfamiliar features of everyday corporate existence."

UNIT 3.—COMBINATIONS OF CORPORATIONS

Observations and Discussions.

Just as the constant pressure toward lower costs has caused a steady trend toward larger industrial units and the replacement of proprietorships and partnerships by corporations, so corporations, in turn, have tended to combine into still larger industrial structures. These are known as *mergers, trusts,* and *holding companies.*

The simplest type of combination is the *merger*—the consolidation of two or more companies into one. At the outset the corporations are independent of one another, each having its own officers, directors, stockholders, and, of course, its own charter. The merger is effected in one of two ways. One of the corporations may absorb the properties of the other or others and continue under its original charter; or all of the old companies may turn over their properties to a new corporation formed for the purpose. The new corporation then starts business under a newly acquired charter. The latter process is sometimes called an *amalgamation.*

Between 1879 and 1896, there appeared a more complicated scheme for combining two or more corporations, called a *trust.* At that time the word "trust" indicated the nature of the organization. A board of trustees was formed which took over the voting rights of all or a majority of the stockholders of each of two or more corporations. Centralized control was thus brought about without destroying the identity of the several corporations involved in the combination. This par-

AMERICAN TELEPHONE & TELEGRAPH COMPANY

History: Incorporated in New York, March 3, 1885, for the purpose of establishing a long distance telephone system throughout the country. Perpetual charter. In March, 1900 acquired all the stock of the American Bell Telephone Co. by an exchange of stock on the basis of two shares of American Telephone & Telegraph Co. for each share of American Bell Telephone Co. The American Telephone & Telegraph Co. with its 24 associated operating companies forms the Bell Telephone System, which furnishes telephone service throughout the United States and connects with telephone systems in Canada and Cuba. It owns and operates the long distance telephone plant which joins together the properties of its associated companies. It is the principal stockholder in the associated companies, owning directly or indirectly the whole or a majority of the common stock of 22 companies and a minority in two companies. Under contract with its associated companies, it is charged with the performance of services for them which have grown in effect into the development of a single policy and program for the Bell System. These services include providing inter-connection between regional operating companies by long distance lines, temporary financing and aid in permanent financing, development of the telephone art, patent protection, etc. At the end of 1927 company sold to its associated companies the telephone instruments which had previously been furnished and maintained by it for the companies, and at the same time reduced the charge to its associated companies under its contract for services, from 4% to 2% of the gross telephone revenue of those companies and at the beginning of 1929 the service charge was further reduced to 1½%.

It owns over 98% of the common stock of the Western Electric Co., Inc., which is the manufacturing, supply and warehousing organization of the Bell System. It is a minority stockholder in the Bell Telephone Co. of Canada and owns 50% of the stock of the Cuban-American Telephone & Telegraph Co., which owns and operates the telephone cables between Florida and the Island of Cuba. A subsidiary, Pacific Telephone & Telegraph Co., owns entire capital stock of Bell Telephone Co. of Nev., Home Telephone Co. of Spokane, and Southern California Telephone Co. On Jan. 7, 1927, transoceanic radio-telephone service was inaugurated between the United States and Great Britain and was later extended to Sweden, Finland, Norway, Denmark, France, Spain (including Ceuta in Africa), Belgium, Holland, Germany, Switzerland, Austria, Czecho-Slovakia, Hungary, Italy, Ireland, Gibraltar, Poland, Luxemburg, Isle of Man, and the City of Danzig. On April 3, 1930, company, in conjunction with the International Telephone & Telegraph Corp., instituted regular telephone service between North and South America. On Sept. 30, 1930, company acquired the entire common stock of Teletype Corporation (150,000 no par shares) through exchange of stock on a share-for-share basis and subsequently sold such interest to Western Electric Co.

CASE 9

Moody's Investors Service.

ticular way of bringing a number of rival business concerns under one direction has no particular significance today. The term "trust," in fact, is now popularly applied to any large business concern that exercises some degree of monopolistic power, a subject which is considered in a later chapter.

Close to the last decade of the last century, another form of organization known as the holding company gained popularity. This is a scheme by which one corporation holds all or part of the stock of one or more other corporations. The subsidiary corporations may, in turn, hold stock in still other corporations. Thus a chain of interests is developed so complicated, in some cases, that even high officials charged with great responsibilities in carrying on the management of the organization are not familiar with all its numerous ramifications. The parent company may be an operating company, that is, actually engaged in some sort of industry or commerce in addition to its capacity as a holding company; or it may occupy nothing but office space, collecting its dividends from its various subsidiaries and paying dividends, in turn, to its own stockholders. Usually the parent company endeavors to hold at least a majority of the stock of its affiliated companies. This establishes unquestioned control. When the capital stock is held by a large number of scattered individuals, however, virtual control may be gained by ownership of something less than a majority of the stock. So long as the management is to their advantage, stockholders do not complain.

1. Refer to Case 9. *Moody's Manual of Investments* is a reference book that gives the history and financial status of every large corporation the capital stock of which is widely held by investors. Case 9 is a quotation from this manual giving information concerning the American Telephone and Telegraph Company. Study this quotation; then prepare answers to the following questions: (a) What sort of combination of corporations does this organization represent? (b) The American Telephone and Telegraph Company owns the whole or a majority of the stock of how many associated companies? It owns a minority of the stock of how many companies? (c) What relation have the Bell Telephone Co. of Nevada, the Home Telephone Co. of Spokane, the Southern California Telephone Co., and the Teletype Corporation to the American Telephone and Telegraph Co.? (d) Prepare a chart showing the organization of the American Telephone and Telegraph Co.

2. Refer to Case 10. Discuss the example of the American Telephone and Telegraph Co. in the light of the advantages of holding companies discussed by Mr. Voorhis.

UTILITY MEN DEFEND HOLDING COMPANIES

Put Expert Managers and Sound Financing Behind Subsidiaries, They Assert.

Opposition caused by plans for mergers in various fields, notably in the food-producing industries, has caused spokesmen for the public utility industry, which is now passing through a period of mergers, to defend them. The utility men contend that the system of holding companies, which has sprung up in their field, is responsible for cheaper financing, better management and interconnection of previously independently operated power plants.

Warren R. Voorhis, vice president of the American Water Works and Electric Company, Inc., in a discussion before the St. Louis Electrical Board of Trade recently, asserted that services rendered by holding companies at the expense of their operating subsidiaries meant economy for the subsidiaries.

"It is important to the rate payer living in a small city and served by a comparatively small utility, that his company have the benefits of sound engineering, capable financing and the best management," said Mr. Voorhis "These must be provided either by the local management, assisted by occasional and expensive counsel, or assisted by a management corporation at far less cost. The assistance which the holding company can and does render to its operating subsidiaries is available all the time, and to each utility, no matter how small, and at an inconsiderable cost. The occasional services of experts command large fees, and in many instances prohibitive ones."

Another advantage of the holding company system, according to Mr. Voorhis, is that it provides a purchasing department with wide knowledge of markets, able to purchase in large quantities at favorable times. He said also that group management permitted the employment of engineers of experience and ability qualified to give the best service to all subsidiaries at a cost much less than the independent company would be required to pay.

CASE 10

Corporations and Wealth

By The Associated Press.

WASHINGTON, May 5.—Representative Rayburn, in opening debate on the securities bill in the House today, reviewed the history of corporations, which, he said, now number about 300,000.

"The combined assets of 200 of the largest corporations in 1930 were estimated at $81,000,000,000," Rayburn said. "The national wealth in 1928 was estimated as $360,000,000,000.

"Thus we have 200 corporations controlling roughly one-fourth of the national wealth, two-fifths of the business wealth and more than four-fifths of the securities wealth represented on the stock markets.

"These larger corporations dominate many smaller corporations. We have a condition where about 2,000 directors control about one-half the corporate wealth."

While national wealth increased

CASE 11

The New York Times.

3. Refer to Case 11. Demonstrate specifically how such conditions as described by Representative Rayburn might be brought about by showing how a capitalist with a fortune of $600,000 might, through a holding company, control other companies that could not be purchased for less than $2,000,000.

4. From the standpoint of public information, can you see any advantage in the holding company over the trust as it was originally constituted?

PACIFIC LIGHTING CORPORATION

AND SUBSIDIARY COMPANIES

Consolidated Balance Sheet, June 30, 1934

ASSETS

Plant Properties and Franchises		$230,495,722.10
Investments in Securities		8,357,007.28
Cash and Securities in Sinking Fund		952,900.53
Current Assets:		
Cash	$5,014,098.97	
Accounts Receivable, less Reserve	4,037,441.81	
Notes Receivable	148,131.93	
Material and Supplies	2,222,737.88	
Total		11,422,410.59
Deferred Charges:		
Discount and Expense on Securities	$5,991,162.42	
Miscellaneous	998,886.04	
Total		6,990,048.46
TOTAL		$258,218,088.96

LIABILITIES

Capital Stock, Pacific Lighting Corporation:		
Preferred, 196,665 Shares of No Par Value	$19,666,500.00	
Common, 1,608,631 Shares of No Par Value	29,937,924.00	
Total		$49,604,424.00
Preferred Capital Stock of Subsidiaries		25,835,875.00
Minority Interest in Common Stock and Surplus of Subsidiaries		1,770.96
Funded Debt		97,295,000.00
Consumers' Deposits and Advances for Construction		2,611,108.36
Current Liabilities:		
Accounts Payable	$1,235,498.30	
Accrued Accounts:		
Bond Interest	1,362,561.06	
Taxes	4,343,559.97	
Dividends Payable	1,793,145.88	
Miscellaneous	376,418.41	
Total		9,111,183.62
Reserves:		
Depreciation	$61,119,829.63	
Insurance and Miscellaneous	2,760,311.94	
Total		63,880,141.57
Earned Surplus		9,878,585.45
TOTAL		$258,218,088.96

CASE 12

Wall Street Journal.

UNIT 4.—THE CORPORATION STATEMENT

Observations and Discussions.

Every corporation whose stock is widely held by the public publishes periodically a financial statement. Although differing in form and terminology, all such statements are based upon certain well-recognized principles of accounting, and can readily be understood once these principles are grasped. We are not concerned here with the details of accounting, for that is a subject in itself, but everyone should be sufficiently familiar with the principles so as to be able to read intelligently any financial statement.

Write to a large corporation whose stock is sold on some exchange for a copy of their latest financial statement, or obtain such a statement from some near-by banker, or watch the advertising columns in the financial section of your daily newspaper for the publication of some public utility, mercantile, or manufacturing corporation's financial statement. Insert this statement in your notebook and by studying the following analysis of Case 12, interpret the statement in your notebook as indicated below.

A corporation may be looked upon as a sort of legally created person. As such, it can own property. The left-hand or upper section of a financial statement,[3] called *Resources* or *Assets*, lists the property that the corporation owns. Thus in Case 12 the corporation owns buildings, machinery, equipment, and "franchises" (meaning certain rights granted by political bodies, such as the right to supply electric current and natural gas within the boundaries of municipalities) amounting in all to $230,495,722.10. The corporation owns securities to the extent of $8,357,007.28. A "sinking fund" is

[3] A financial statement always consists of two columns: the Resources, or Assets, and the Liabilities. The column listing the Resources, or Assets, may be placed just above the column listing the Liabilities, or the two columns may be placed side by side, the column listing the Resources, or Assets, appearing to the left of the other.

being created according to the statement; that is, funds are being accumulated for some specific purpose, such as, for example, to pay back borrowed capital. The corporation owns this sinking fund until it is actually used. This amounts to $952,900.53. The company owns current assets made up of (1) cash, (2) accounts receivable, that is, claims on other individuals or corporations for goods delivered or services rendered (it is customary in such an item to deduct a percentage of the total for possible uncollectible items), (3) promissory notes, and (4) materials and supplies. These items amount in all to $11,422,410.59. The term "deferred charges" refers to certain expenses which have been incurred but which have not been fully charged to the expenses of running the business. Thus, it has cost the corporation $5,991,162.42 to market its securities. The securities in question are, perhaps, bonds that run for fifty years. The corporation will therefore deduct one-fiftieth of this item from its statement each year. The balance shown each year, then, is not an item of property upon which the corporation could ever realize anything; however, it is property in the sense that it is a definite benefit in which the company participates during the period that its bonds are outstanding. The total deferred charges are $6,990,048.46. The total amount of property owned by the corporation is worth $258,218,088.96.

1. Refer to your notebook, and, using the statement there inserted, explain the nature of the property listed under "Resources," or "Assets."

When a person dies, all that he owns is distributed among his heirs. When a corporation goes out of existence, all that it owns must likewise be distributed. The right-hand or lower side of the statement, called *Liabilities,* shows to whom the assets or resources of the corporation would go if the corporation should cease business. In other words, while the left or upper side of the statement shows what the corporation has, the right-hand or lower section shows who may ultimately lay claim to it. Thus the two sides of the statement are simply two different classifications of the same thing, namely, the property of the corporation. Referring again to Case 12, we find that all capital stock items have to do with

the stockholders. These items are: $49,604,424.00, $25,835,-875.00, and $1,770.96. The term "funded debt" indicates that the corporation has certain bonds outstanding. The bondholders, therefore, have a claim against the property of the corporation to the extent of $97,295,000.00. Customers and others have deposited with the company $2,611,108.36 and are entitled to that much of the total assets. The current liabilities of the company indicate that those who have rendered service or sold goods to the company are entitled to $1,235,498.30; the accrued accounts show that the bondholders may claim $1,362,561.06 for interest, governmental units may claim $4,343,559.97 for taxes, stockholders may claim $1,793,145.88 for dividends when and if declared, and others not mentioned may claim $376,418.41. There are no other specific claims against the corporation, but the directors have thought it wise to set aside certain reserves to cover possible contingencies. For example, if any buildings or equipment were sold, it is improbable that they could be sold for the full amount at which they are valued on the statement; hence the item of "depreciation." Losses may be sustained from fire, accidents, and the like; hence the item of "insurance." So long as no contingencies occur, this $63,880,141.57 belongs to the owners of the corporation who are, as we have already seen, the stockholders; but by placing this item under "reserves," the directors give notice that it is not safe to count on it. This leaves the item of $9,878,585.45 which the statement indicates is the total profit earned to date. As such it belongs to the stockholders or owners of the corporation. Should the corporation go out of existence, they would receive this in addition to their original investments indicated under the capital items. Thus the right-hand or lower side of the statement provides for the distribution of all the property listed in the left-hand or upper column, and the two columns balance.

2. Refer to your notebook, and, using the statement there inserted explain to whom the property held by the corporation belongs.

3. Refer to Case 12 and assume that the corporation pays in cash to the stockholders the dividends that have been declared by the directors. Alter the statement accordingly.

Think: The corporation will then have how much less cash? What item must be changed? The corporation will be relieved of what claim against it? What other item must therefore be changed? Does the statement still balance?

4. Refer again to Case 12. Alter the statement to show each of the following transactions, starting with the original statement in each case:

(a) All the "accounts payable" are paid.
(b) Materials are bought on credit to the extent of $550,000.00.
(c) Notes receivable are paid.
(d) Additional cash profits of $1,000,000.00 are made.
(e) $5,000.00 in bonds are retired out of the sinking fund.
(f) Buildings and equipment are sold for $1,000,000.00 in cash.

5. Construct a corporation financial statement from the following items: cash, $3,000.00; surplus, $5,000.00; bills owing to other corporations, $2,000.00; unfinished materials, $2,000.00; current items due the corporation, $1,000.00; capital stock, $5,000.00; finished materials, $1,000.00; plant and equipment, $5,000.00.

The *par value* of a stock is the amount stated in the stock certificate. This par value theoretically expresses the amount of the stockholders' original investment. Thereafter, "par value" is meaningless because, as we shall see below, the actual value of the stock varies with the fortunes of the business and general economic conditions. This has given rise to no-par value stock. Stock of no-par value is usually (though not necessarily) shown on the financial statement at its issue price, that is, the amount of the stockholders' original investment. When so shown, the issue price can easily be ascertained by dividing the total sum outstanding with the number of shares issued.

6. Refer to Case 12. Assume that the preferred stock is shown at its issue price. What is the issue price of the preferred stock of the Pacific Lighting Corporation?

The *book value* is the amount per share which each stockholder would receive if all the resources were converted into cash at the values shown on the statement and if all the debts were paid. After all debts are paid, the preferred stock has

first claim upon the remaining assets of the corporation, the preferred stockholders being entitled to at least the return of their investments figured at the issue price. If the preferred stock is "preferred" to that extent and no more, then the common stockholders are entitled to all the remaining assets of the corporation, and the book value expresses the sum per share of common stock that each stockholder would receive.

7. Refer to Case 12. What is the book value of the common stock of the Pacific Lighting Corporation?

The *normal market value* of stock is the amount which, when invested at the current rate of interest, will yield an amount equal to the customary earnings per share of stock.

8. Refer to Case 12. Suppose that the customary earnings of a corporation amount to $2.27 per share per year, and the current rate of interest is 6%; what would be the normal market value of the stock?

Think: Let x equal the amount which when invested at 6% would yield $2.27.

Then 6% of $x = \$2.27$ or $.06\ x = \$2.27$

$x = ?$

The *actual market value* of stock is that figure at which the stock can be sold. It would seem, at first thought, that this should be the same as the normal market value; but actual market values usually anticipate conditions. For example:

9. (a) What would be the effect upon the actual market value of the stock if news items were published to the effect that an exceptionally favorable contract had been awarded the company? (b) What would be the effect if news were received of the death of a very successful manager?

In times of stock market booms, actual market values exceed normal market values because speculation is rampant. Stocks are bought with little thought of their earning power but with the sole object in view of selling them at a higher figure than the price paid. Obviously, there is a limit to this procedure. Some relatively minor occurrence or unfavorable

bit of news starts an orgy of selling; then the whole structure crashes. Those who bought stocks at high prices and still hold them lose heavily. The wave of selling usually sends actual market prices below normal market prices. Then buying is resumed. Thus the curve of actual market prices fluctuates above and below the more constant curve of normal market prices.

10. Refer to Case 12. About the time that this statement was published, the common stock of the Pacific Lighting Corporation was selling on the New York Stock Exchange for 28. How does this compare with its normal market value? With its book value? What period of the cycle is indicated by these comparisons?

Stock is said to be *watered* if the value of the property of the corporation expressed in dollars is in excess of a fair estimate of the actual market price of such property.

11. Suppose that the corporation acquired some real estate for $15,000.00 that in reality was worth only $5,000.00; would this change the book value of the stock expressed in so many dollars? If the circumstances were known, would it be likely to change the actual market value?

Conclusions.

A. In this chapter you learned, first, about the corporate form of organization.

1. What can you say about the growth in size and number of American corporations?
   (a) How do you account for this growth?
2. What are the customary steps in the formation of a corporation?
   (a) How are the directors elected?
   (b) How are the officers chosen?

B. In the second place, you learned about certain advantages, disadvantages, and abuses of the corporate form of organization.

1. Summarize the advantages and the disadvantages of this form of business organization.
   (a) Compare with partnerships and proprietorships.
2. What are some of the abuses of the corporate form of business organization?

C. You learned also about how combinations of corporations are brought about.

1. Explain the origin of the word "trust" as used in this connection.

2. What is a merger?
3. Describe the organization of a holding company.
   (a) What are some of the advantages claimed for the holding company plan of combining corporations?
   (b) How may such a scheme bring about a high concentration of economic power?

D. Finally, you learned how to read a corporation financial statement.

1. Explain how it is that the two sides of a financial statement are really two different classifications of the same thing.
   (a) What does the upper or left-hand side of the statement show?
   (b) What does the lower or right-hand side of the statement show?
   (c) Why do both sides of a financial statement always add up to the same figure?
2. What different "values" are ascribed to the stock of a corporation?
   (a) How do you calculate the book value?
   (b) What significance has the par value?
   (c) How is the normal market value determined?
   (d) What factors influence the actual market value?

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CHAPTER IV

CHAPTER IV

Money

UNIT 1.—THE USES AND QUALITIES OF MONEY

Observations and Discussions.

In order fully to appreciate what an important role money plays in our economic life, we must first recall the inconveniences of a purely *barter* economy.

1. Refer to Case 13 (page 57). Walter Bennett, of Hartford, has a large supply of tires, gas, oil, etc., wanted by the Hartford company, but cannot use any sand, gravel, or traprock. He is refurnishing his house and is looking for a dining room table, some chairs, and a desk. His neighbor, Elmer Jones, on the other hand, while wishing to dispose of just the kind of furniture wanted by Bennett, is in need of food, but Bennett has just enough food for himself and his family. A third citizen, John Smith, is a farmer. He is rebuilding his house. He does not need furniture, but he does need the very things offered by the Hartford company. Unfortunately, however, he has none of the things acceptable to that company, although he has a quantity of potatoes, onions, and cabbages sufficient to supply not only his own needs but those of Jones as well. Explain how the wants of all four can be satisfied without the use of money.

Suggestion: Diagram the problem this way:

The Company

Wants: tires, gas, oil, etc.
Has: sand, gravel, traprock.

John Smith

Wants: sand, gravel, traprock.
Has: potatoes, onions, cabbages.

Walter Bennett

Wants: furniture.
Has: tires, gas, oil, etc.

Elmer Jones

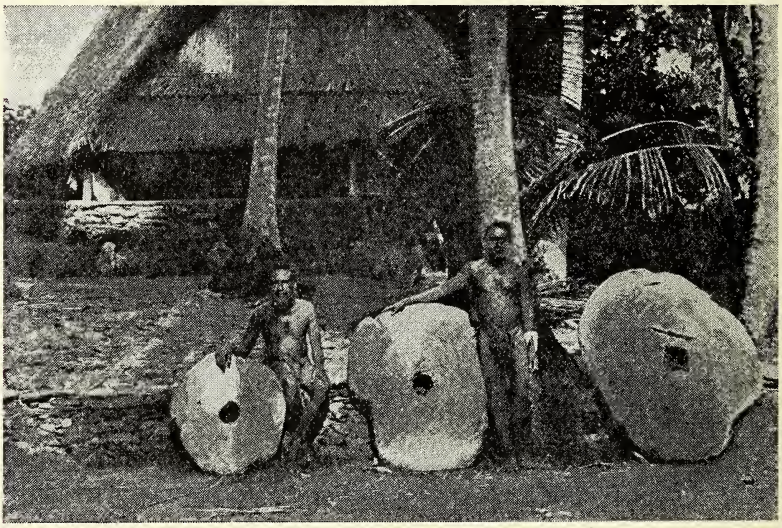
Wants: potatoes, onions, cabbages.
Has: furniture.

2. Can you infer from question 1 what is meant by "double coincidence of barter"?

3. Refer to question 1. If Walter Bennett and Elmer Jones would accept sand, gravel, and traprock *temporarily,* these commodities would then be used as a medium of exchange or money. Explain how this would make the trading easier.

4. In what sense is an exchange of a commodity for money but half a transaction?

5. Refer to Case 14 (page 57) and list some of the commodities that have been used as money.



Courtesy Chase National Bank Collection of Moneys of the World, New York.

FÉ, OR STONE MONEY FROM YAP, ONE OF THE CAROLINE ISLANDS. The perforated center enables the money to be carried on a pole. A Yap "coin" about 30 inches in diameter and weighing over 100 pounds is worth 10,000 coconuts, one-fourth acre of land, an 18-foot canoe, or a wife. Larger pieces, up to 12 feet in diameter, do not circulate but mark the possessors as men of wealth.

As might be expected, some commodities have better served as money than others. To serve as money at all, certain qualities are essential; to be really desirable as money, other characteristics should be present; and to attain the standard of an ideal money, still another qualification is necessary, but it should be observed at the outset that the ideal money is still to be discovered or devised.

Anything to be used as money must necessarily be limited in quantity and be universally wanted. Obviously, nothing will do for money that can be had in unlimited amounts without effort, for, under such conditions, there exists no power in exchange. Certainly no one will surrender a valuable product or perform a skilled service for something the quantity of which is so plentiful that it can be obtained without sacrifice. A convenient money is desirable although, of course, not essential. Modern coins are reasonably convenient. They encompass within a small bulk a relatively high value and may, therefore, be carried about without being burdensome. The same can hardly be said of the enormous stone wheels used as money in at least one primitive community. Likewise, the use of modern alloys has made it possible to produce money that is durable, easily recognized, uniform in quality, and easily divisible—characteristics which are well enough to have, but which may nevertheless be absent.

An ideal money must have, in addition to all of the above characteristics, stability of value. This means that whatever quantity of money is necessary for the purchase of a wide variety of commodities today, that same quantity of money will purchase the same stock of goods tomorrow, next year, and the years to follow. In other words, an ideal money must have uniform purchasing power. It is difficult to see how any commodity money can meet this ideal. Devices to attain this desired stability have been proposed, however, and will be considered in a later chapter.

6. Refer to your list selected from Case 14, and criticize the articles there listed in the light of (a) the essential, (b) the desirable, and (c) the ideal qualities for money.

7. Do you think that the authority of a government is necessary in order to have money, or does the use of some kind of money arise spontaneously to meet a need?

8. Criticize the use of gold and silver as money in the light of your list describing the characteristics of an ideal money.

9. Money has been defined as "anything which is generally acceptable in a community in exchange for all other goods and services." Justify this definition by applying it to various forms of both modern and primitive money.

Money serves purposes in our economic life other than merely that of acting as a *medium of exchange* for goods and services. It may, for example, be used as a *measure of value,* that is, as a measuring rod. Just as a foot rule is used to measure the width of a desk in terms of inches, so may money be used to measure value in terms of whatever commodity happens to be used for money.

10. An old poster, dated 1703, lists the following: "One Yard of Broad Cloth—Three Beaver Skins; Five Pecks of Indian Corn—One Beaver Skin," etc. Show that this is a case of using money as a measure of value.

11. Refer to Case 15. Show that money is here used as a measure of value.

Money may also be used as a *standard of deferred payments.* When credit is granted, the value of the commodity that changes hands is defined in terms of the money in use; then, at some future time when payment is made, the value thus defined is recognized by both parties to the transaction as the basis of settlement.

12. Refer to Case 16. Show that money is here used as a standard of deferred payment.

13. Refer back to Case 12 (page 42). Select items in which money is used (a) as a measure of value, and (b) as a standard of deferred payment.

UNIT 2.—STANDARD MONEY AND SUBSIDIARY COINS

Observations and Discussions.

Modern economic society assumes a great deal in its monetary system that would be quite impossible in a more primitive system. Nevertheless, money today is still based directly or indirectly upon a commodity. In the United States and in most of the other countries of the world, that commodity is gold, and the monetary unit of the country—the dollar, pound sterling, franc, mark, etc.—is defined in terms of gold. In such countries, then, it is said that the governments have made gold the *standard money.*

STRANGE FORMS OF CURRENCY IN SMITHSONIAN COLLECTION

Exhibit at Chicago Fair Shows Articles Used as Money, From Fish Hooks to Millstones

The Chinese found that an iron razor blade was good for shaving expenses as well as beards. Of careful craftsmanship, and of no small intrinsic value, the Chinese razor blade was a natural medium of exchange. Later it became a symbol of value rather than an object of actual utilitarian value in itself. It was then fashioned in bronze or even cut from the precious jade. In the process of simplification the blade was first eliminated leaving only the round handle with a perforated center.

The collection assembled by the Smithsonian Institution includes such articles as shells, bright feathers, axes, spear heads, fish hooks, blocks of salt, blocks of pressed tea and tobacco, all sorts of skins, glass bottles, coconuts, eagle feathers, cocao beans, whale teeth, porcupine quills and teeth, tails of animals, red hair from behind the ear of the flying fox, stone and clay beads, millstones of yellow limestone, hoes and spades, crosses of copper, ingots of iron, buffalo robes, and hundreds of other articles.

CASE 14 *United States News.*

Son Pays His Father's Debt of $120 Fifty Years After the Latter's Death

Special Correspondence, THE NEW YORK TIMES

SHANGHAI, Dec. 20.—An extraordinary instance of Chinese filial piety, involving half a century of hard labor and the savings of a lifetime, has just been officially recorded with admiring comments in the chronicles of the Tszchi district.

In 1883 a man named Chang died penniless and owing a debt of $120 to his best friend, a man named Yih. Chang left a "will" ordering his son, then 10 years old, to repay the debt. But Mr. Yih appeared at the Chang funeral and ceremoniously forgave the debt.

Last week the Chang boy, now a white-haired man 60 years old, appeared at the Yih homestead with $120 to discharge the debt.

The Yih family refused to accept the money, so an arbitrator was called in, and finally the money was given to the local primary school.

CASE 16

$3,000,000 FIRE RUINS OAKLAND (CAL.) FERRY

Flames From Slip Swiftly Devour Boat—15,000 Commuters Affected.

OAKLAND, Cal., May 7 (AP).—The key route interurban-ferry terminal five miles out in San Francisco Bay, at the end of three miles of open trestle, was crippled by a $3,000,000 fire last night. Company officials who surveyed the damage today, however, said service would be resumed Tuesday for the system's 15,000 daily commuters.

FIRM OFFERS BARTER PLAN.

Hartford Concern Will Trade Sand for Tobacco, Gas and Shoes.

HARTFORD, Conn., Jan. 21 (AP).—Barter has made its bow in Hartford. A sand, gravel and stone firm listed tires, gas, oil, shoes, business suits, working clothes, tobacco, three automobiles, two light trucks and cotton goods as among the things it will accept in exchange for sand, gravel, traprock and services performed by it.

Richard B. Dunning, the concern's sales manager, said the merchandise it will accept in place of money is needed by the company and its fifty employes.

CASE 13

CASE 15 *The New York Times.*

1. (a) Refer to Case 17. According to the Gold Standard Act of 1900, how was the dollar defined? (b) "Fineness" indicates the degree of purity of the metal. For example, "900 fine" means 900 parts of pure metal to every 1,000 parts alloy; in other words, nine-tenths or 90% pure. According to the Gold Standard Act of 1900, how much pure gold did the dollar contain?

NATION ONLY TWICE OFF GOLD STANDARD

First Suspension Caused by the Civil War and Second Came Early in 1917.

Abandoning the double standard of currency which it had attempted to establish in 1792 as a result of Alexander Hamilton's report to the Treasury, the United States on Feb. 21, 1853, adopted the gold standard.

Eight years the standard functioned, but with the outbreak of the Civil War in 1861, the issuance of United States Notes, which were not redeemable in gold, compelled the New York bankers to suspend gold payments and this action forced Congress to do likewise. Government regulations, however, required that customs duties be paid in gold, so that there was still plenty of gold in the country.

In 1865 Congress pledged its support to resume specie payments, but nothing was done. Again in 1869 it made a similar pledge, but no action was taken until the beginning of 1879, when payments in gold were again resumed.

The gold standard continued to function, but the panic of 1893 with agitation for repeal of silver purchases, followed later by public opinion and political discussion, brought a controversy over the standard which led to an Act of Congress on March 14, 1900, which was to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States. The bill was known as the "Financial Bill" or "Gold Standard Act."

The general idea of the bill was to define the standard as follows:

"That the dollar consisting of twenty-five and eight-tenths grains of gold nine-tenths fine, as established by section 3511 of the Revised Statutes of the United States, shall be the standard of value, and all forms of money coined or issued by the United States shall be maintained at a parity of value with this standard, and it shall be the duty of the Secretary of Treasury to maintain such parity."

Except for the interruption caused by the Civil War, this country adhered to the gold standard until 1917. Keeping up exchanges for belligerent powers caused the tide of exports of gold to jeopardize our position. Gold exports were then licensed by a board of Federal Reserve officials, and it was not until 1919 that unlicensed exports of gold were permitted.

CASE 17

The New York Times.

For a country to be on the *gold standard,* not only must its monetary unit be defined in terms of gold, but other conditions must prevail as well. For example, the government must accept gold and only gold in unlimited quantities from anyone for coinage. This is called *free coinage.* The United States government has decreed that there shall be free coinage

of gold and of gold only. In addition, all other forms of money must be freely exchangeable for gold, there must be unrestricted melting of gold coins into bullion, and it must be provided that gold money may be used for the legal settlement of all debts, both public and private.

Free coinage must be distinguished carefully from *gratuitous coinage.* The latter indicates that the government will mint coins without charge. Usually a charge is made for manufacturing coins. Any such charge is called *mintage.* When the charge is just sufficient to cover the cost of coinage, it is called *brassage.*

The very conditions of the gold standard fix the price of gold—that is, make it impossible for the price of gold to vary.

2. In 1900 what was the price per ounce of pure gold?

> **Think:** There are 480 grains to the ounce. One dollar contained how much pure gold? How many dollars, then, were represented in 480 grains or one ounce of pure gold?

3. Show that so long as a country is on the gold standard the price of gold cannot change.

> **Think:** Would a gold miner be likely to accept any less for his product than he could obtain from the government? Would a goldsmith be likely to pay any more than it would cost him to melt gold coins?

Subsidiary coins are those which are worth less as metal than their face value. The term *token money* is sometimes used in a broad sense to include all subsidiary coins. Other writers restrict the use of the term *token money* to describe only those coins made of baser metals—nickel, copper, and zinc—such as the United States cents and five-cent pieces. The silver dollar resembles a subsidiary coin in every way except that it is lawful money for the settlement of all debts without limit as to amount.

4. Why are subsidiary and token coins necessary?

The government obtains metal for use in its subsidiary coins by purchasing it from producers just as other supplies are purchased. This is called buying on *government account.* Whatever the price happens to be at the time, that is the price the government pays.

5. According to the Silver Act of 1878, the silver dollar is defined as 412.5 grains of silver 900 fine. Suppose the government bought silver for 51.6 cents per ounce, what would the actual silver in the dollar be worth?

> **Think:** How many grains of pure silver does the dollar contain? Express this in terms of ounces (there are 480 grains to the ounce). How much is this quantity of silver worth at 51.6 cents an ounce?

The government makes a profit, then, in coining subsidiary coins. This profit is, aside from the expense of manufacturing the coin, the difference between the face value of the coin and the value of the metal in it. This profit is called *seigniorage.*

6. Refer to question 5 above. If the manufacturing cost is two cents for every silver dollar manufactured, how much seigniorage per dollar does the government make?

7. (a) If the market price of silver advanced to $1.50 an ounce, how much loss would the government sustain on every silver dollar manufactured? Ignore manufacturing cost. (b) What would people who had silver dollars in their possession be likely to do with them?

> **Think:** Follow the reasoning outlined for question 5. Would the silver dollars be worth more as metal or as money? How could the silver dollars be used as metal?

The ultimate result would be, of course, that silver pieces would go out of circulation. They would go out of circulation because the currency made of silver would be the better or more valuable currency. Its market value—its value as metal—would exceed its face value, or its value as money. This illustrates a general tendency in economic life known as *Gresh-*

am's Law. In more general terms Gresham's Law may be stated thus: "Less valuable, or inferior, money tends to drive the more valuable, or better, money out of circulation when both are equally available."

8. When a country is on the gold standard, its silver coins are "inferior" money, since their face value exceeds the market value of the metal with which they are made. Why, then, even under normal circumstances does not this "inferior" or silver money drive the "more valuable" or gold money out of circulation in accordance with Gresham's Law?

> **Think:** Refer to the conditions of the gold standard stated on pages 58–59 and see if one condition stated therein would not prevent this from happening.

In times of emergency or uncertainty, the gold coins do go out of circulation because people hoard gold. For this reason the government, in 1934, while taking over all of the gold in the Federal reserve banks, made the hoarding of gold illegal.

UNIT 3.—PAPER MONEY

Observations and Discussions.

All paper money is a promise to pay. It is acceptable in payment for commodities and is freely exchangeable dollar for dollar for metallic money, simply because people believe that the promise is good.

1. Would you expect to find paper money in circulation in primitive communities, or is it an economic device peculiar to advanced civilization?

The promise to pay may be secured by metal up to its full face value, to something less than its full value, or not at all. If it is wholly secured, then for every dollar of paper money issued there is a metal dollar or its equivalent in coin or bullion held in the treasury. Such paper money is called *representative money.* It is simply a warehouse receipt.

2. (a) Why should representative money be issued? (b) Refer to Case 18 and select the kinds that you believe are representative money.

When the promise to pay is not secured by an amount of coin or bullion equivalent to the full face value of the paper, but is secured to some extent in this or in some other manner, it is called *credit money.* In the United States all paper money that is not representative money is credit money.

3. Refer to Case 18. Name the kinds of credit money issued and in each case show what backing it has.

Present Currency and Its Backing

Special to THE NEW YORK TIMES.

WASHINGTON, March 9.—The present currency and its backing were tabulated tonight as follows:

Classification.	Amount Outstanding.	Backing.
Federal Reserve notes..	$3,000,000,000	40 per cent gold to 100 per cent eligible paper.
Gold certificates.....	591,000,000	100 per cent gold.
National banknotes.....	863,000,000	100 per cent circulating bonds.
Silver certificates	484,000,000	100 per cent silver dollars.
United States notes (greenbacks)	286,000,000	$156,000,000 gold set aside by Gold Standard Act of 1900.
Treasury notes of 1890..	1,215,000	
Federal Res. banknotes.	2,645,000	100 per cent bonds.
Silver dollars	38,000,000	backed by own value.
Subsidiary silver	292,000,000	backed by own value.
Minor (token) coins....	121,000,000	backed by own value.

(This list excludes the authorization of new currency made by Congress today, which could run into many billions of dollars.)

CASE 18 *The New York Times.*

If the promise to pay is not secured either by a reserve of metal or in some other way, but rests simply upon the ability and the disposition of the issuing agency to make good its promise, it is called *fiat money.* The word "fiat" means "command." Fiat money circulates, then, by virtue of the fiat or command of the government.

4. Refer to Case 18. Is there any fiat money in circulation in the United States? When, in civilized society, people become so accustomed to paper money that they accept it without thinking of its backing, why not issue fiat money and pay all the debts of the national government and thus reduce taxation?

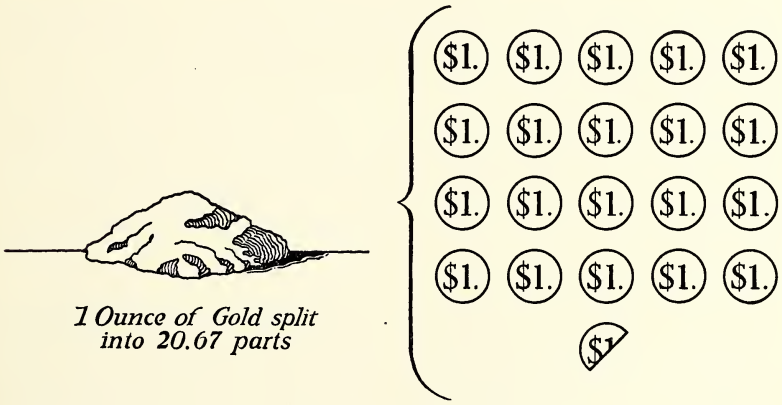
UNIT 4.—RECENT CHANGES IN OUR MONETARY SYSTEM

Observations and Discussions.

In 1934 fundamental changes were made in our monetary system. The dollar was *devaluated,* meaning that the gold content of the dollar was reduced, and a new policy in reference to silver money was established.

1. Refer to Case 19 (page 65). On January 31, 1934, the President, by virtue of authority vested in him by Congress, revalued, or redefined, the dollar. (a) What was the new definition? (b) How much pure gold did the dollar then contain?

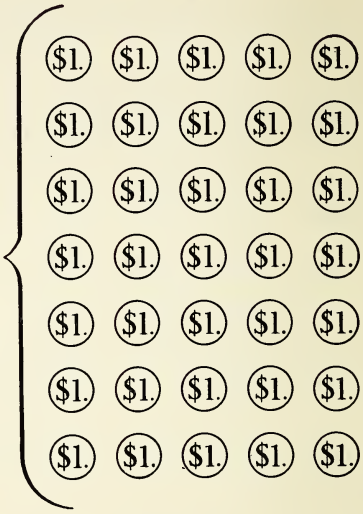
This devaluation of the dollar is illustrated in the following sketch:



According to the Act of 1900, each ounce of pure gold may be considered to have been broken up into twenty and sixty-seven hundredths parts.

According to the Presidential decree of January 31, 1934, each ounce of pure gold might be broken up into thirty-five parts. Of course, the gold was not actually broken up and coined; it was held as bullion. But one ounce of pure gold *represented* thirty-five dollars instead of twenty and sixty-seven hundredths dollars as it formerly did. Compare the above sketch with the one on the following page.

1 Ounce of Gold split into 35 parts



2. By following the method outlined in question 2, page 59, show that this changed the price of pure gold to $35.00 an ounce.

3. Refer to Case 19. In what sense did this change make the dollar worth only 59.06 cents?

> **Think:** Taking the gold content of the 1900 dollar as a basis, what proportion of this gold content did the revalued dollar contain?

4. Refer to Case 19, change no. 3. The government took physical possession not only of all the gold in the Federal reserve banks, but of all of the gold in the country. (a) What conditions of the gold standard did this action destroy? (b) What conditions of the gold standard remained? (c) What was the new monetary standard called?

For all newly mined gold, or gold bought abroad, the government paid the new price of $35.00 for each ounce of pure gold. But for all the gold then in circulation, the government paid the old price calculated in question 2, page 59. The government thus made seigniorage on all the gold then in circulation that came into its possession.

5. Refer to Case 19. How many ounces of pure gold must have come into the possession of the government at the 1900 price for it to have made seigniorage of $2,792,859,126?

The Silver Purchase Act (approved June 19, 1934) directs the President to acquire a silver reserve equal to one-third

GOLD BULLION STANDARD

Metal to Be Sold at $35 as Well as Bought to Steady the Dollar.

$2,792,859,126 THE PROFIT

Gold Dollar Cut From 25.8 to 15 5/21 Grains 9/10 Fine—Silver Dollar Unchanged.

By ARTHUR KROCK.

Special to THE NEW YORK TIMES.

WASHINGTON, Jan. 31.—At 3:10 o'clock today the President, acting under powers conferred on him by Congress in the Thomas amendment of 1933 and the Monetary Bill passed this week, put his signature to a proclamation and, by so doing, automatically effected these momentous changes:

1. Reduced the dollar's gold weight from 25.8 grains to 15 5-21 grains, 9-10 fine, making its gold value 59.06+ per cent of the par fixed by the act of 1900. In other words, the American dollar is now worth 59.06 cents plus in gold.

2. Fixed $35 (less a ¼ of 1 per cent mint charge) as the price this government will pay per fine troy ounce for gold mined in or delivered to the United States, authorizing the Secretary of the Treasury, through the New York Federal Reserve Bank, to begin purchasing at that price tomorrow morning. It was announced at the Treasury that the government will also sell gold at $35 an ounce if that method appears necessary to keep the dollar at 59.06 cents plus, or any later value that may be set.

3. Took title for the government on all the gold held by the Federal Reserve Banks, for which new gold certificates will be given to these banks.

4. Created a dollar profit on this gold, estimated at $2,792,876,058, and credited to the United States Treasury.

5. Set up $2,000,000,000 of this sum to be used as a fund, operated exclusively by the Secretary of the Treasury, to stabilize the dollar on international exchange at as near 59.06 cents as can be done; and to be used also to support the government bond market when necessary.

6. Put the United States on an international gold bullion standard as a substitute for the old gold standard.

CASE 19

The New York Times.

of the gold reserve. To carry out the program, it has been estimated that the Treasury needed to buy, at the time the act was passed, 1,300,000,000 ounces of silver. On August 9, 1934, the President "nationalized" silver; that is, ordered all silver bullion then in the United States to be turned over to

the United States mints. The mints were at that time authorized to buy this silver at the rate of 51.6 cents per fine ounce.

Case 20 points out that silver certificates were not issued on a "cost basis"—that is, one dollar for each 371.25 grains of pure silver purchased (page 60). Instead, the certificates

SILVER CURRENCY LIMITED TO TERMS OF PURCHASE ACT

Certificates Will Have Standard Backing of $1.29 an Ounce Instead of Cost Basis.

CONFUSION THUS AVOIDED

Roosevelt a Month Ago Ordered That Old Rate Be Followed, the Treasury Reveals.

PROFIT SO FAR IS $6,140,000

He supposed a hypothetical purchase by the Treasury of 1,000,000 ounces of silver under the Silver Purchase Act at a price of 51.6 cents an ounce, or a total cost of $516,000.

Under the act, the Treasury is obliged to issue silver certificates up to the dollar amount of the transaction, that is to say, to the amount of $516,000.

At the official and traditional rate of $1.29 an ounce, 400,000 ounces of the newly acquired silver would have to be set aside to cover these certificates. The 400,000 ounces of silver would have cost the Treasury only $206,400.

The Treasury account so far would appear as follows:

Certificates issued, $516,000.
Cost of silver covering them, $206,400.
Seigniorage, $309,600.

The seigniorage item would appear in the Treasury's general receipts. The remaining 600,000 ounces of silver would be carried at its purchase price of 51.6 cents an ounce in the silver bullion item of the Treasury statement, increasing that figure by $309,600.

CASE 20

The New York Times.

had a "standard backing of $1.29 an ounce." That is, certificates were issued up to the gross dollar amount of silver purchased; then as many ounces of silver were set aside to secure those certificates as the number of times $1.29 was divisible into this gross sum. The difference between $1.29, the amount at which no seigniorage is made, and the actual price paid for the silver was the seigniorage actually made. For example:

6. Refer to Case 20. Follow the method (but not the figures) therein outlined and calculate the seigniorage the government will make when it procures its full quota of silver.

Think:

——— 1,300,000,000 ounces of silver at 51.6 cents.
(*a*)

——— (*b*) Ounces of silver at $1.29 necessary to secure silver certificates up to dollar amount of total transaction (*a* ÷ $1.29).
(*c*)

——— Total cost to government of silver necessary to secure silver certificates (*c* x 51.6 cents).
(*d*)

——— Amount of seigniorage (*a* − *d*).

——— (*e*) Ounces of silver remaining (*b* − *c*).

——— Increase in silver bullion item of treasury statement (*e* x 51.6 cents).

UNIT 5.—FOREIGN MONEY

Observations and Discussions.

Every American traveler abroad knows how necessary it is to translate the monetary denominations of foreign countries into dollars. Indeed, until one becomes very familiar with a foreign currency system, it is always necessary to do this in order to judge the value of things purchased. And foreigners visiting the United States find it equally necessary to think of dollars in terms of the currency with which they are familiar.

Most people simply have in mind a ready-made formula, such as: "So many dollars equal one pound sterling," the English monetary unit. Or: "So many francs or marks," the French and German monetary units respectively, "equal a dollar."

As students of economics, however, we must know how the formula itself is ascertained. And this is a surprisingly simple process. To find the value of one currency in terms of another, both of which are defined in terms of gold, express the

two monetary units in terms of pure gold, using the same unit of weight. Then divide one by the other. For example:

Express the value of an English sovereign in terms of dollars, defined according to the Gold Standard Act of 1900 (see Case 21).

Weight of English sovereign = 123.27447 grains, 916 2/3 fine.

Weight of dollar (July 15, 1933) = 25.8, 900 fine.

123.27447 x .916 2/3 = 113.00 grains, pure gold in sovereign.

25.8 x .900 = 23.22 grains, pure gold in dollar.

113.00 ÷ 23.22 = $4.8665, value of English sovereign in terms of dollars.

FOREIGN EXCHANGE

Thursday, Aug. 2, 1934

Closing Rates

Quotation on sterling represents dollars and decimals of a dollar; all others represent cents and decimals of a cent.

Parity of the exchanges in the following tabulation is based on the new gold value of the United States dollar as established by Presidential proclamation on Jan. 31:

Europe

	Thursday.	Wednesday.	Week Ago.	Year Ago.
STERLING—Par $8.2397 per sovereign.				
Demand	$5.03¾	$5.03½	$5.03⅜	$4.53
Cables	5.03¾	5.03½	5.03⅜	4.53
Com., 60 d.	5.02¾	5.02	5.02⅜	4.51½
Com., 90 d.	5.02¼	5.01½	5.01⅛	4.51¼
FRANCE—Par 6.6335 cents per franc.				
Demand	6.59½	6.59⅛	6.58⅞	5.35½
Cables	6.59½	6.59⅛	6.58⅞	5.35½
GERMANY—Par 40.3325 cents per mark.				
Demand	38.75	38.72	38.55	32.65
Cables	38.75	38.72	38.55	32.65

CASE 22

FOREIGN EXCHANGE

Saturday, July 15, 1933

Closing Rates

Quotation on sterling represents dollars and decimals of a dollar; all others represent cents and decimals of a cent.

Europe

	Saturday.	Friday.	Week Ago.	Year Ago.
STERLING—Par $4.86656 per sovereign.				
Demand	$4.78	$4.78	$4.70¾	$3.54⅛
Cables	4.78	4.74	4.70¾	3.54⅝
Com., 40 d.	4.76¼	4.76¼	4.69¼	3.52⅞
Com., 90 d.	4.76¼	4.76¼	4.69¼	3.52⅝
FRANCE—Par 3.9179 cents per franc.				
Demand	5.61	5.61	5.56	3.91⅝
Cables	5.61	5.61	5.56	3.91¼
GERMANY—Par 23.82 cents per mark.				
Demand	34.25	34.25	33.80	23.71
Cables	34.25	34.25	33.80	23.72
ITALY—Par 5.2632 cents per lira.				
Demand	7.56¼	7.57	7.53	5.10¾
Cables	7.56¼	7.57	7.53	5.11¼
BELGIUM—Par 13.9045 cents per belga.				
Demand	20.05	20.05	19.85	13.85½
Cables	20.05	20.05	19.85	13.86

CASE 21

The New York Times.

This result is called the *mint par of exchange.* If you actually appeared at a French, German, or English bank, however, and wished to exchange your dollars for francs, marks,

or pounds sterling, the rate used by the bank to calculate the exchange would not be, in all probability, the exact mint par of exchange. The actual market rate of exchange always varies somewhat from the mint par, owing to circumstances that will be considered in the chapter "Foreign Goods." However, the mint par of exchange is basic. So long as countries are on a gold standard, all calculations start from this point.

1. Refer to Case 22. The value of the English sovereign in terms of dollars, defined as of August 2, 1934, is how much? Show how this is calculated.

2. Refer to Case 22. The value of the French franc in terms of dollars, defined as of August 2, 1934, is how much? Show how this is calculated. The franc is defined as 65.5 milligrams of gold, 900 fine. There are 15.432 grains to the gram, and 1,000 milligrams to a gram.

> **Think:** The dollar, defined as of August 2, 1934, contains how many grains of pure gold? The franc contains how many milligrams of pure gold? To what is this equivalent in grams? In grains? Divide by the dollar weight.

3. Refer to Case 22. The value of the German reichmark in terms of dollars, defined as of August 2, 1934, is how much? Show how this is calculated. The German reichmark is defined as .358423 grams of pure gold.

4. How would you compute the value in dollars of the monetary unit of a country on a silver basis?

> **Think:** How much pure silver in the monetary unit? What is the market price of silver?

5. Why would the fluctuating price of silver make trade difficult between a country on a silver basis and one on a gold basis?

Conclusions.

A. You have learned in this chapter how money is used—its essential, desirable, and ideal qualifications.

1. Explain three ways in which money is used.
   (a) Explain the inconveniences of barter.
2. What are the essential qualifications of money?
   (a) Name some commodities which had these essential qualifications and were used as money.

3. What qualification would a commodity have to have to make an ideal money?
   (a) Has such a commodity ever been discovered?
   (b) What comes the nearest to such a commodity?

B. You have learned about standard money and subsidiary coins.

1. What commodity is usually used today as the basis for money?
   (a) According to the Act of 1900, how was the dollar defined?
2. What is the gold standard?
   (a) What is meant by free coinage? Gratuitous coinage? Mintage? Brassage?
   (b) Why is the price of gold fixed when a country is on the gold standard?
3. What are subsidiary coins?
   (a) How is seigniorage made from the coinage of silver dollars?
   (b) Explain Gresham's Law.

C. What change occurred in the monetary standard of the United States in 1934?

1. What is the difference between the gold standard and the gold bullion standard?
2. Describe the process of devaluating the dollar.
   (a) Explain how the government makes seigniorage by this process.

D. What kinds of paper money are issued in the United States?

1. Describe each kind in terms of the kinds of paper money that may be issued in any country.
   (a) What is fiat money?

E. You have learned how to express the currency of one country in terms of that of another country.

1. Explain mint par of exchange.
   (a) Show by means of mint par of exchange how pounds sterling may be converted into dollars.
2. What complications arise when the monetary unit of a country is expressed in silver?

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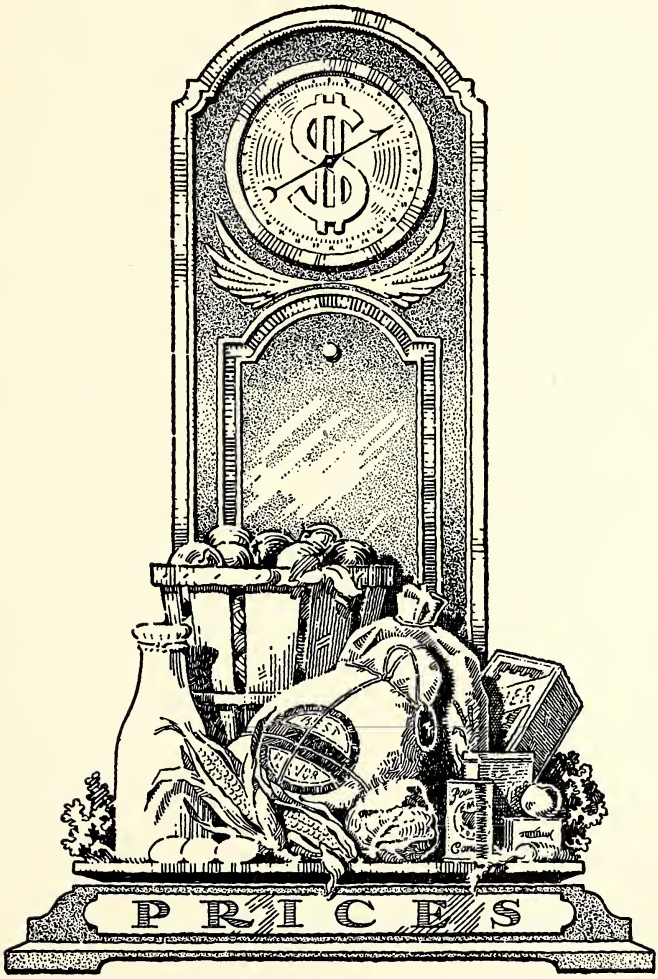
CHAPTER V



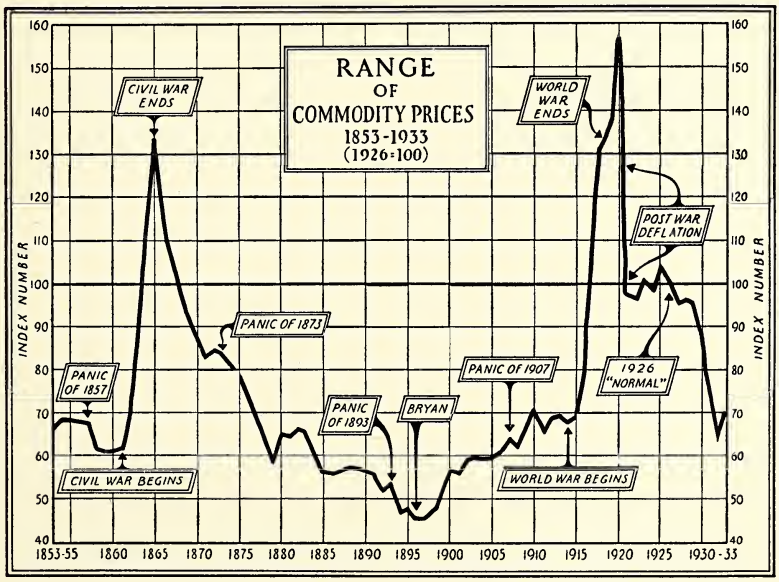
CHAPTER V

Prices

UNIT 1.—CHANGES IN THE GENERAL PRICE LEVEL

Observations and Discussions.

The term *commodity prices* mentioned in Case 23, or the general commodity *price level,* as it is sometimes called, is a sort of composite or average of the prices of all commodities



The New York Times.

CASE 23

at any particular time. A glance at Case 23 shows that this general commodity price level is not the same at all times; in fact, it fluctuates widely over a period of years. Our present investigations are concerned with finding out how this general

commodity price level is determined, in what ways its fluctuations affect our economic life, why the fluctuations occur, and what plans have been proposed to bring about a more stable price level.

1. Here is a list of the prices on various commodities for different years. By examining the figures in their present form, can you compare one year with another and conclude accurately whether prices in general have advanced or declined? What is the difficulty encountered in attempting to do so?

Commodity	*Quality*	*Unit*	*1913*	*1916*	*1920*	*1923*	*1926*	*1928*	*1932*
Sirloin steak	Best	lb.	.254	.273	.437	.391	.413	.478	.333
Round steak	Best	lb.	.223	.245	.395	.335	.356	.420	.289
Rib roast	Best	lb.	.198	.212	.332	.284	.303	.350	.241
Pork chops	Best	lb.	.210	.227	.423	.304	.395	.348	.212
Bacon	Best	lb.	.270	.287	.523	.391	.503	.440	.241
Lard	Best	lb.	.158	.175	.295	.177	.219	.186	.088
Eggs	Strictly fresh	doz.	.345	.375	.681	.465	.485	.464	.272
Butter	Tub	lb.	.383	.394	.701	.554	.531	.565	.274
Milk	Grade A	qt.	.089	.091	.167	.138	.140	.142	.109
Flour	Best white	⅛ bbl.	.809	1.078	1.985	1.152	1.470	1.323	.784
Bread	Best white	lb.	.056	.073	.115	.087	.094	.091	.068
Cornmeal	Yellow	lb.	.030	.034	.065	.041	.051	.053	.038
Rice	Unpolished	lb.	.087	.091	.174	.095	.116	.100	.067
Potatoes	Local	pk.	.255	.405	.945	.435	.735	.405	.255
Sugar	Granulated	lb.	.055	.080	.194	.101	.069	.071	.051
	TOTALS		(*a*)	(*b*)	(*c*)	(*d*)	(*e*)	(*f*)	(*g*)

Your answer to the above question will suggest the need for some device by which the general price level of one year may be compared with that of some other year. An *index number*

is a means of accomplishing this end. There are various ways of compiling an index number. One of the simplest follows:

Columnar totals in the table on page 76 are represented by *a, b, c, d,* etc. In constructing an index number, we must select some year as a *base year.* Price conditions prevailing at other times are then compared with this base year. If 1913 be taken as a base year, then the index number of this year is placed at 100. The index number for 1916 bears the same proportion to 100 as *b* does to *a.* If the index number for

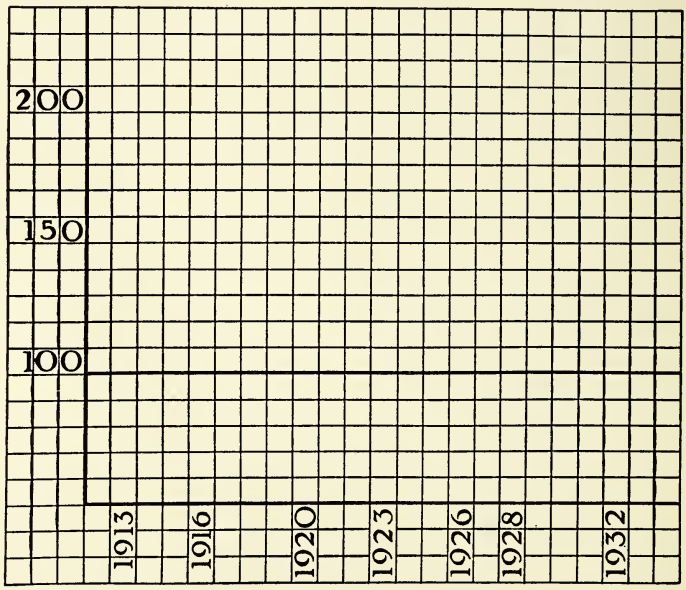
Commodity	*Quality*	*Unit*	Current Prices		
			1st Store	*2nd Store*	*3rd Store*
Sirloin steak	Best	lb.			
Round steak	Best	lb.			
Rib roast	Best	lb.			
Pork chops	Best	lb.			
Bacon	Best	lb.			
Lard	Best	lb.			
Eggs	Strictly fresh	doz.			
Butter	Tub	lb.			
Milk	Grade A	qt.			
Flour	Best white	⅛ bbl.			
Bread	Best white	lb.			
Cornmeal	Yellow	lb.			
Rice	Unpolished	lb.			
Potatoes	Local	pk.			
Sugar	Granulated	lb.			
Totals					
Average of Three Stores			(*h*)		

1916 be represented by x, then $\frac{x}{100} = \frac{b}{a}$. Likewise the index number for 1920 bears the same proportion to 100 as c does to a. If the index number for 1920 be represented by y, then $\frac{y}{100} = \frac{c}{a}$.

2. Compile index numbers for 1916, 1920, 1923, 1926, 1928, and 1932, selecting 1913 as the base year.

3. Appoint a committee of three to investigate current prices in the local stores. Each member of the committee should prepare a table such as the one shown at the bottom of page 77. This will confine the investigation to a list of certain definite commodities, and, so far as possible, to certain specified grades in each case. Three different stores should be visited.

Reproduce in your notebook the table shown at the bottom of page 77 and complete it as indicated when the committee reports are made. Then, in the manner explained above, calculate an index number for the current year, using, as before, 1913 as the base year.



4. Draw a chart such as the one shown in the accompanying illustration. Plot on this chart the index numbers that you compiled. Compare your chart with Case 23.

5. Refer to Case 23. (a) When the price level is high, as it was in 1920, does a given amount of money purchase relatively much or little? In 1920, then, was the purchasing power of the dollar great or small? (b) What happened to the price level between 1920 and 1932? During this period, then, did the purchasing power of the dollar increase or decrease?

To say, therefore, that the price level has changed is the same as to say that the purchasing power of the dollar has changed.

Students at a Local Food Store Ascertaining the Prices of Various Commodities to Calculate Changes in the General Price Level.

6. (a) What was the quality of an ideal money as considered on page 55? (b) What does Case 23 prove as to the presence or lack of this quality in our present money?

The purchasing power of the dollar is commonly shown in "pie" charts. One entire circle represents the "normal" dollar, or the purchasing power of the dollar in the base year—1913 in this case. A part of a second circle represents the purchasing power of the dollar at some other period, say 1916. This second circle is divided into 100 parts representing 100 cents, and as many cents are pointed off as represent the value

of the 1916 dollar, or how many cents worth of goods, based on 1913 prices, the whole dollar would buy in 1916.

7. Construct "pie" charts showing the value of the dollar in 1913 (the base year, $1.00=100), 1916, 1920, 1923, 1926, and 1928.

> **Think:** The purchasing power of the dollar shrank from 1913 to 1916 just to the extent that the price level advanced. The price level advanced from 100 to the 1916 index number. Therefore the problem is to find a number which bears the same relation to 100 as 100 does to the 1916 index number.
>
> Therefore: $\frac{x}{100} = \frac{100}{\text{1916 Index number}}$. Find the number, then proceed *clockwise* and point off this number of cents in your circle. Block off in black the portion of the circle thus pointed off.

This discussion leads us to the meaning of two terms which are frequently used in economic reasoning: *value* and *price*. "Value" is the quantity of one thing that is given in exchange for another thing. "Price" is the amount of money that is given in exchange for any one unit of a commodity or a service.

8. Using the terms as explained above, can prices change while values remain the same?

> **Think:** Suppose that two bushels of corn will exchange for one bushel of wheat. What is the *value* of wheat in terms of corn? What is the *value* of corn in terms of wheat? Suppose that the *price* of wheat advances from $1.00 to $2.00 a bushel, and that the *price* of corn advances from 50¢ to $1.00 a bushel. Have the *prices* of these commodities changed? Have their relative *values* changed?

9. Can values change while prices remain the same?

> **Think:** Suppose that two bushels of corn exchange for one bushel of wheat, and that the price of corn is 50¢ a bushel and the price of wheat is $1.00 a bushel. Suppose that corn becomes so scarce and wheat so plentiful that one bushel of corn exchanges for one bushel of wheat. Would this condition change prices?

10. (a) Can some prices decline while the general price level advances, or the reverse? (b) Can relative values change while the general price level remains the same?

UNIT 2.—EFFECTS OF PRICE CHANGES

Observations and Discussions.

Inflation, an abnormally rapid rise in the general price level, and *deflation,* an equally violent decline, may cause very severe economic disturbances. Even the less violent fluctuations affect, in some degree, the welfare of many millions of people. It is these social and economic effects of changes in the general price level that concern us in the present investigation.

1. Duplicate the chart prepared in connection with question 4, page 78. Using a dotted line, plot on this chart the following index numbers:

INDEX NUMBERS OF WAGES PER HOUR [1]
(Exclusive of Agriculture)

1913	100	1920	233
1916	111	1923	217
1917	127	1926	228
1918	161	1928	231
1919	174	1932	184

Label the solid line "prices," and the dotted line "wages." (a) Did prices or wages rise faster in the interval between 1913 and just before 1920? (b) What was the tendency from 1920 to 1926? (c) From 1926 to 1932?

The term *money wages* refers to the actual number of dollars received by the worker in return for his services. The term *real wages* refers to the compensation received by the worker in terms of the quantity of goods that the money wages can buy.

2. Judging by the chart prepared in connection with question 1, explain in terms of money wages and real wages the effect upon the worker of a rapid advance in the general commodity price level.

---

[1] Warren, George F., and Pearson, Frank A., *Prices,* p. 197, quoting from *Monthly Labor Review,* Vol. 32, No. 2, p. 143, February, 1931. These index numbers have been changed in the above table so as to make 1913 the base year.

3. Refer to Case 24. (a) Would inflation be likely to reach the wage scale immediately? (b) Why is it that a large number of labor strikes are likely to occur during a period of advancing prices?

INFLATION DANGERS CITED BY KEMMERER

Would Curtail the Purchasing Power of Fixed Incomes.

Special to the World-Telegram.

INDIANAPOLIS, May 26.—Inflation would strike a vital blow at our great educational, scientific, charitable and other public welfare institutions by heavily reducing the purchasing power of their fixed income from endowments, Dr. Edwin W. Kemmerer, Walker professor of international finance at Princeton University, declared here late yesterday before a joint session of the Indiana Bankers Assn. and the Indiana Sound Money Committee.

The reduction in the ranks of rich men, which serious inflation would bring about, also would cut much of the support out from under our colleges, research laboratories, hospitals and other endowed institutions, Dr. Kemmerer declared.

Despite this "great injustice" that inflation would cause to public welfare organizations, it would help "certain classes like farmers, home buyers with mortgages on their properties, and others who are really suffering under the burden of long-term debts during this temporary period of abnormally low commodity prices," Dr Kemmerer said.

CASE 25

New York World-Telegram.

GOLD MINING HIT BY PRICE UPTURN

American Industry Faces Rising Production Costs With Fixed Return for Metal.

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WASHINGTON, July 3. — One American industry not sharing in the business upturn but finding itself worse off with every price advance is gold mining.

CASE 26

WAGE ADVANCE VITAL.

Otherwise, Inflation Is Not Worth Risk, S. H. Scheuer Asserts.

Inflation of any type which fails to reach to the wage scale and directly to increase employment in a large way is "not worth the risks involved and will prove to be unsatisfactory," Sidney H. Scheuer of Scheuer & Co., cloth brokers and textile consultants, said here yesterday.

CASE 24

The New York Times.

4. (a) During a period of declining prices, will merchants and manufacturers be likely to place large orders? Why, or why not? (b) What effect will this have upon industrial activity in general? (c) What will be the social effect—on employment, for example? (d) Identify rising prices and declining prices with periods of prosperity and depression.

5. (a) The price of wheat in 1868 was $2.54 a bushel; in 1879 it was $1.22 a bushel. Suppose that a farmer mortgaged his farm in 1868 for $3,000; how many bushels of wheat did this represent? (b) Suppose that he paid off this mortgage in 1879; how many bushels of wheat did the $3,000 represent at that time? (c) In terms of wheat, then, how much was borrowed and how much returned?

6. (a) In general, how are *debtors* (people who owe debts) affected during a period of advancing prices? (b) How are *creditors* (people to whom debts are owed) affected? (c) How is each affected during a period of declining prices?

7. Refer to Case 25. Do you agree or disagree with the viewpoint therein expressed? Give reasons for your decision.

8. Refer to Case 23, page 75. If a large number of debts were incurred during the 1926 period marked "normal," what advantages would be gained by restoring the general commodity price level to the point marked 100 on this chart?

9. Refer to Case 26. Explain why the gold mining industry should find itself worse off with every advance in the general price level.

> **Think:** Does the gold miner receive more money for his product? Are his expenses greater?

10. Why might you expect economic maladjustments to become more and more severe as civilization evolves from a purely agricultural economy to an industrial and trading economy?

> **Think:** Under the circumstances would the use of money become more and more important?

UNIT 3.—REASONS FOR CHANGES IN THE PRICE LEVEL

Observations and Discussions.

Almost everyone knows, at least in a general way, about the forces of supply and demand in economic life. When the supply of a particular commodity is great and the demand is relatively small, the price is low; when the demand is great and the supply is small, the price is high. This matter we shall consider in detail in a later chapter; here it is necessary to refer to just that much of it and no more.

At any given time, there is a certain stock of money in the community—in the banks, in the purses of the people, and held by the merchants. This is called the quantity of money in circulation. Imagine, for a moment, that neither money nor commodities enter or leave the community except in the ways we shall mention. Suppose, now, that suddenly a gold mine is discovered. The ore is sent to the mint, coined, and returned to the mine operator, who pays his laborers, settles his obligations for materials, pays his rent, and has something left over for himself. Everyone in the community now has more money than ever before.

1. (a) How will this be likely to affect the demand for commodities? (b) Is it likely that the supply of commodities can be increased at once? (c) What will be the effect, then, upon prices? (d) Will the people have *more* of the necessities and comforts of life, or will they simply *pay more* for the same quantity of things that they bought before?

2. Refer to Case 27 (page 87). Why should the silver-buying program, considered in Chapter IV, be expected to advance the price level?

3. Review the explanation of the devaluation of the dollar, page 63. What effect would this tend to have upon the price level? Give reasons for your answer.

Instead of the discovery of the gold mine, as pictured above, suppose that a persuasive salesman visits the community and sells for cash a large issue of the capital stock of a distant oil company. People now have less money to spend than ever before.

4. (a) What will be the effect upon the demand for goods? (b) Merchants will be as desirous as ever to dispose of their stocks. What, therefore, will happen to prices? (c) Will the people have a smaller *quantity* of the good things of life than they had before, or will they simply *pay less* for the same quantity that they bought before?

5. Rule a sheet of paper in accordance with the scale on page 84.

This is called "arithlog," or "semi-logarithmic," ruling. It is no harder to use than ordinary coördinate or cross-ruled paper, and has the added advantage of enabling two sets of figures of widely differing magnitudes to be plotted close together for easy comparison. Arrange your paper so that there are seventeen points equally spaced along the horizontal axis (at the bottom of the paper). Label these 1913, 1914, 1915, etc., to 1929. Note the "1" at the bottom of the scale. Add a cipher to this, making it 10. Do likewise to the "2" just above, making it 20, etc., until you come to the second "1," to which add two ciphers, making it 100. Change the second "2" to 200, etc., until you come to the third "1," which then becomes 1000. The spaces between the first "1" and the second "1" have a value of 10. Those between the second "1" and the third "1" have a value of 100. Now plot two curves on this chart just as you would on an ordinary chart, one for the wholesale index numbers and the other for the money in circulation given in the following tabulation. In plotting these figures, use the first three digits only; thus for 1914 the number to be plotted is 346. Entitle the chart "Money in Circulation and Index Numbers of Wholesale Prices, 1913–1929," and interpret it in the light of questions 1 to 4 above.

MONEY IN CIRCULATION IN MILLIONS AND TENTHS OF MILLIONS OF DOLLARS[2]

Year	*Wholesale Index Number*	*Money in Circulation*	*Year*	*Wholesale Index Number*	*Money in Circulation*
1913	70		1922	97	4,463.2
1914	68	3,459.4	1923	101	4,823.3
1915	70	3,319.6	1924	98	4,849.3
1916	86	3,649.3	1925	104	4,815.2
1917	118	4,066.4	1926	100	4,885.3
1918	131	4,481.7	1927	95	4,851.3
1919	139	4,876.6	1928	98	4,796.6
1920	154	5,467.6	1929	97	4,746.3
1921	98	4,991.0			

Money that is being used simply as a medium of exchange changes hands frequently. How frequently depends upon conditions. In modern communities where people live in close contact with one another and enjoy the facilities of modern banking, money changes hands with relative rapidity. It has been estimated, for example, that in the United States money changes hands about thirty times a year. In India,

[2] *Statistical Abstract of the United States,* 1930.

on the other hand, much money is hoarded; it changes hands, therefore, less frequently. The degree of rapidity with which money circulates is called the "*velocity of circulation* of money." Continuing the story of our isolated community, let us suppose, now, that a new savings bank is organized in the community. In order to induce people to open accounts in the new bank, the officials distribute small home safes or banks in which money may be kept until a sufficient amount has accumulated to warrant opening an account. Throughout the community, a quantity of money now finds its way into these small safes where it is kept for a month or more. This slows up the velocity of circulation. There is less money available for purchases.

6. Trace the sequence of events to their effect upon the general commodity price level.

7. Refer to Case 28. If people lost faith in their money, they would be inclined to get rid of it, or, in other words, to spend it rapidly. (a) How would this affect the general price level? (b) Explain Professor Kemmerer's fears of such acts of the government as devaluating the dollar.

8. Refer to Case 29. (a) Is this a rapid or slow velocity of circulation? (b) How would a velocity such as this tend to affect the price level?

9. Refer to Case 30. If this were done, and if people hoarded the money, would the price level be affected? Why, or why not?

Volume of trade is increased when new commodities and services are offered to the people of the community. Substitute for the enterprising salesman episode (mentioned a few pages back) the condition of a motion-picture theater established in a community where none existed before. This induces people to spend a certain sum per week for entertainment. Obviously, they will have less to spend for other things.

10. Trace the sequence of events to the effect upon prices.

11. Prepare a sheet of arithlog paper as explained above. Entitle the chart: "Money in Circulation, Index Numbers of Wholesale Prices, and Steel Production, 1868–1879." Plot the following statistics and properly label the resulting curves:

'34 Price Rise Is Expected on Silver Buying

$940,500,000 Expansion in Currency to Aid Commodities, Capital Says

By The Associated Press

WASHINGTON, June 26.—Administration officials believe the new silver purchase plan will cause a currency expansion of at least $940,500,000, with corresponding increases in commodity prices by the end of the year.

CASE 27

New York Herald Tribune.

KEMMERER WARNS OF INFLATION PERIL

Like Controlling a Hurricane When Public Loses Faith in Money, He Says.

'VELOCITIES' ARE STRESSED

Special to THE NEW YORK TIMES.

PHILADELPHIA, Dec. 28.—In his paper read before the American Economic Association today Professor E. W. Kemmerer of Princeton University, who believes that controlled inflation is sure to fail, said, in part:

"If the public once loses confidence in its money, controlling inflation is like controlling a hurricane. At such a time the volume of the circulating medium is of secondary importance.

"The fact that these velocities in critical times are to a large extent a question of volatile class and mass psychology is one reason why controlled inflation on any large scale, at least for a long time to come, is bound to fail."

CASE 28

The New York Times.

$1 Changes Hands 21 Times In Week in a Nebraska Test

Special Correspondence, THE NEW YORK TIMES

BLAIR, Neb., Feb. 9.—In an effort to find out how frequently money changes hands The Pilot-Tribune recently sent out a $1 bill with a slip attached asking for endorsements of all who came in possession of it.

In a week it came back with twenty-one endorsements, including those of a hardware store, clothing store, two drug stores, confectionery, restaurant, building and loan association, the telephone company, three groceries and a barber shop.

The paper asserted, as a result, that $500 started out in the same way would go a long way toward clearing up the local debts of the town.

The community is temporarily without a bank. To facilitate trade a community exchange is being maintained.

CASE 29

The New York Times.

Planes Raining Money Is New Inflation Plan

By The Associated Press.

ATLANTA, Sept. 14.—Governor Eugene Talmadge thinks a good plan for making currency inflation effective and widespread "would be to print a lot of ten and twenty dollar bills and scatter them over the country by throwing the money out of airplanes."

The Governor holds that expansion of the currency will not affect farm prices or relieve the depression unless the new money goes directly to the people.

"The effectiveness of any inflation depends upon the method of the inflation," he said today. "If the money is turned over to the banks it will get caught in the cogs and will not reach the people for two or three years."

CASE 30

The New York Times.

TOTAL MONEY IN CIRCULATION [3]

1868	$680,886,198	1874	$776,083,031
1869	665,773,364	1875	754,609,388
1870	676,284,427	1876	727,609,388
1871	718,616,114	1877	722,314,883
1872	741,799,412	1878	729,132,634
1873	753,799,412	1879	818,631,793

INDEX NUMBERS OF WHOLESALE PRICES [4]

(1860=100)

1868	160	1874	133
1869	153	1875	127
1870	142	1876	118
1871	136	1877	110
1872	138	1878	101
1873	137	1879	96

PRODUCTION OF STEEL [5]

(Long Tons)

1868	26,786	1874	215,727
1869	31,250	1875	389,799
1870	68,750	1876	533,191
1871	73,214	1877	569,618
1872	142,954	1878	731,977
1873	198,796	1879	935,273

It should be borne in mind that the forces influencing the general price level do not act singly, but simultaneously; and at certain periods in United States history, certain forces acting in one direction more than offset other counteracting tendencies.

In the above chart, the curve representing steel production suggests the production of hundreds of new things, steel being such a basic industry. This curve is a sort of index, therefore, indicating the general trend in the volume of trade.

12. Interpret this chart in the light of your knowledge of the forces acting upon the price level.

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[3] Guetter and McKinley, *Statistical Tables Relating to the Economic Growth of the United States,* p. 14.

[4] *Ibid.,* p. 49.

[5] *Ibid.,* p. 36.

13. Complete the following table:

If			*Prices Will:*
The quantity of money in circulation:	The volume of trade:	The velocity of circulation of money:	(Insert "increase" or "decrease")
Increases	Remains the same	Remains the same	
Decreases	Remains the same	Remains the same	
Remains the same	Increases	Remains the same	
Remains the same	Decreases	Remains the same	
Remains the same	Remains the same	Increases	
Remains the same	Remains the same	Decreases	

UNIT 4.—PROPOSALS TO STABILIZE THE PRICE LEVEL

Observations and Discussions.

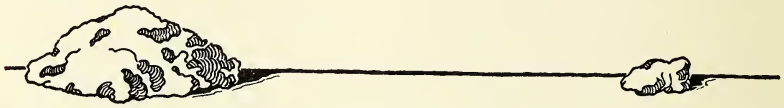
1. Refer to Case 31 (page 93). Compare Professor Tugwell's explanation of "sound money" with the quality of an ideal money discussed on page 55.

Many suggestions have been made as to how to attain a money with uniform purchasing power and hence stabilize the price level. Many believe that *bimetallism* would come at least nearer the goal than the gold standard or any form of *monometallism.*

You have learned that currencies based on the gold standard are definitely tied to gold and to gold only. Bimetallism has been defined as "a monetary system under which both gold and silver serve concurrently as a legal monetary standard." Accordingly, under a bimetallic system, the monetary unit would be defined in terms of both gold and silver, thus establishing a definite ratio between them; there would be free coinage of both gold and silver; both would be declared legal tender; free exchangeability one for the other would be required; and no restrictions upon melting either gold or silver would be imposed. One reason why the general price level fluctuates is, as you know, because the quantity of money in

circulation varies. It is claimed by the advocates of bimetallism that under such a standard it is unlikely that both metals would become either scarce or abundant at the same time. A safeguard would therefore be provided, so it is argued, against fluctuations in the price level caused by changes in the quantity of money in use at any particular time. It will be recalled that the quantity of money in circulation is but one of three forces affecting the general price level. This argument for bimetallism, therefore, may be challenged at the outset; but aside from this, when bimetallism is adopted by any one nation, or even by a limited group of nations, other complications arise the nature of which can best be seen by tracing actual events.

In 1792 when our coinage system was established, bimetallism was adopted. The government made a careful investigation of the markets where gold and silver bullion were constantly being bought and sold by merchants, manufacturers, and miners, and discovered as a result of these investigations that fifteen ounces of silver exchanged for one ounce of gold.

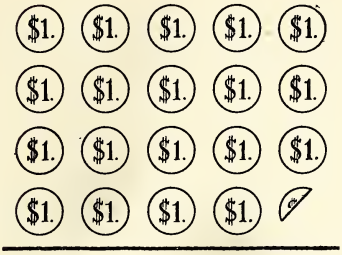


15 ounces of Silver exchange for 1 ounce of Gold

The government, therefore, in defining the monetary standards did so according to the ratio of 15 to 1.

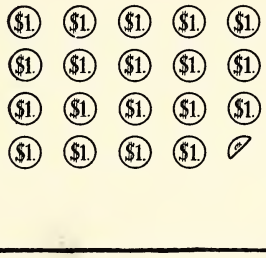
This meant that the silver miner might bring his metal to the mint and for every fifteen ounces of it receive nineteen and a fraction silver dollars, or nineteen and a fraction gold dollars, or paper money that might be exchanged for either. Likewise, the gold miner might bring his metal to the mint and receive for every ounce of it the same number of dollars in any one of the three forms above mentioned. If, on the other hand, either the silver miner or the gold miner elected to sell his metal to the manufacturers or merchants, the market price would yield nineteen and a fraction dollars for every fifteen ounces of silver or for every one ounce of gold.

15 ounces of Silver make:



19 and a fraction Silver Dollars

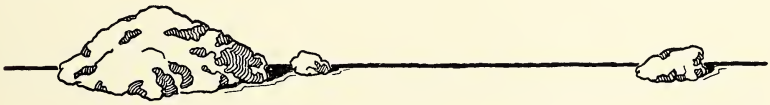
1 ounce of Gold makes:



19 and a fraction Gold Dollars

2. (a) Under these conditions, did it make any difference to the silver miner whether he sold his metal to the merchants for use in the arts or delivered it to the mint to be made into coins? (b) Would the gold miner have any preference in the matter?

Market prices, however, seldom remain fixed for very long periods of time. As customs and fashions change, new demands grow and old ones disappear. These changed conditions of supply and demand constantly disrupt old exchange ratios and make revised prices necessary. Thus it was with gold and silver. Market conditions did not long remain as the government had found them. Gold became scarce in relation to silver. Its value rose slightly in consequence. Metal merchants found it necessary to offer 15½ ounces of silver to obtain one ounce of gold. Then the market condition was:



15 and ½ ounces of Silver exchange for 1 ounce of Gold

But the law had already been enacted establishing the legal monetary standard of silver and gold according to the ratio of 15 to 1.

3. Under these conditions, to whom would the silver miner deliver his metal?

> **Think:** If he delivered it to the mint, he received either nineteen and a fraction silver dollars, or the same quantity of gold dollars. If he chose gold dollars, he could melt these and exchange the bullion in the market for how much silver? Would this net him a profit? What if he delivered his silver to the merchants? Which would he do?

4. To whom would the gold miner deliver his metal? Why?

5. A few years later France adopted the bimetallic system at the mint ratio of 15½ to 1. (a) What additional opportunity did this give the gold miner? (b) Which metal was undervalued at the United States Mint—that is, which metal was valued less at the mint than it was in the market? (c) Under these conditions which coins would be driven out of circulation? (Review Gresham's Law.)

6. In 1834 the legal ratio was changed by the United States government to 16 to 1, but the market ratio remained 15½ to 1. (a) Under these conditions, to whom did the gold miner deliver his metal? Why? (b) To whom did the silver miner deliver his metal? Why? (c) Which metal was undervalued at the mint? (d) Which coins were driven out of circulation?

7. What effect do you think the discovery of gold in California in 1849 and 1850 had on the situation?

Large quantities of silver were discovered in the United States during the last quarter of the nineteenth century. In 1875 the market ratio was 17 to 1; in 1878, 18 to 1; in 1886, 21 to 1. Great Britain adopted the gold standard in 1816, and in 1878 France and other countries in Europe followed.

8. Had the United States continued on the bimetallic standard at the mint ratio of 16 to 1, show according to Gresham's Law what the effect would have been upon the monetary system of the United States.

9. Refer to Case 32 and to page 65. What recent changes have been made in our monetary policy that might be interpreted as a step toward bimetallism? Discuss the merits of a national bimetallic standard.

Under a condition of international bimetallism and the establishment of a uniform legal ratio among all countries, the market ratio would probably not deviate very much or for very long periods from the mint ratio. For example, the sud-

TUGWELL DEFINES 'SOUNDEST DOLLAR'

Offering Equality From Year to Year in Paying Power, It Defeats the 'Shylocks.'

NO 'CRAWLING BACK' NOW

Heaped-Up Corporate Surpluses Held 'Death of Trade' in Speech Made at Chicago.

Special to THE NEW YORK TIMES.

Professor Tugwell declared that "sound money" was a phrase which meant different things to different persons. He held the soundest dollar to be that defined by President Roosevelt as one having substantial equality of purchasing and debt-paying power from one generation to another.

CASE 31

The New York Times.

Bankers See Another Step in Program of Bi-Metalism.

Local bankers do not see any immediate significance attaching to the nationalization of silver decreed by President Roosevelt yesterday.

They regard it as a further step in the direction of monetary experimentation, and as indicating that the Administration has not as yet reached the conclusion that recovery via the depreciated currency route should be abandoned.

The banking world here sees it, however, as another step toward the declared policy of the administration for bi-metalism—that is, the injection of silver into the nation's monetary base in the ratio of 25 per cent silver to 75 per cent gold.

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CASE 32

New York World-Telegram.

Managed Currency Survey Ordered?

"Brain Trust" New Members Linked with Problem of Keeping Money Level

WASHINGTON (U. P.) — President Roosevelt was reliably reported today to have ordered a survey of ways of managing the country's currency to prevent violent fluctuations in purchasing power of the dollar.

The President's ultimate goal is to keep the purchasing power of the dollar stable after it reaches a level satisfactory to the administration.

CASE 33

Newark Evening News.

COMMODITY DOLLAR VIEWS.

Economists Differ on the Value of President's Proposal.

President Roosevelt's proposal for a commodity dollar, based on 1924-25 price levels, brought out a variety of opinions from economists during the week. Many were in favor of it, feeling that it is one sure way of maintaining the upward trend in prices, while others believed that any "tinkering" with the long-established monetary system of gold and silver is certain to have disastrous results.

Proponents of the plan argue that it is unfair to measure the wealth and income of the American people in dollars of a fixed gold content when convertibility into gold has been suspended. The plan, it is held, would remove from our economic system fortuitous gains and losses resulting from the fluctuating purchasing power of the monetary units, would reward the efficient producer of goods and would provide consumers with merchandise and services at the lowest possible costs.

CASE 34

The New York Times.

den influx of a large quantity of silver would, perhaps, so increase the supply of this metal on the market that temporarily an ounce of it would no longer be worth the amount of gold that the mint offered. This would precipitate large deliveries of silver to the mint and large deliveries of gold to the market. Silver would soon become relatively scarce in the market and gold relatively plentiful, which condition would tend to restore the original ratio.

10. Discuss the merits of an international bimetallic standard.

A second plan to do away with fluctuations in the price level is called *managed currency.* In its extreme form this plan would do away with metal altogether, provide for the issue of fiat money, and regulate its quantity in accordance with index numbers.

11. Refer to Case 33. Discuss the possibilities of attaining this goal by a managed currency system.

> **Think:** What is involved so far as confidence in the government is concerned? Has economic society drifted so far away from commodity money as to make fiat money possible? How about times of uncertainty? Refer to Case 28, page 87. Could this factor be controlled?

The *commodity dollar* is a third plan to regulate the price level. This plan proposes constantly to alter the gold content of the dollar to compensate for advances or declines in the general level of prices as measured by index numbers.

12. How might the general price level be regulated in this way?

> **Think:** When the general price level advances, what may this indicate as to the value of money? Under these circumstances, what would be the effect of adding to the gold content of the dollar? Why? When the general price level declines, what does this indicate as to the value of money? Under these circumstances, what would be the effect of decreasing the gold content of the dollar? Why?

13. Refer to Case 34. Discuss the viewpoints there expressed.

Conclusions.

A. What is the general commodity price level?

1. Why does it fluctuate?
   (a) What has this to do with the ideal quality of money?
2. How are the fluctuations measured?
   (a) Explain a simple method of constructing an index number.
   (b) Explain the significance of percentage charts showing the "value of the dollar."
3. Explain by means of the general commodity price level how values can remain the same while prices change.

B. You have learned that fluctuations in the general commodity price level cause certain definite effects in economic life.

1. How is general economic activity affected:
   (a) During a period of rising prices?
   (b) During a period of declining prices?
2. How are wage earners affected:
   (a) During a period of rising prices?
   (b) During a period of declining prices?
3. Explain how fluctuations in the general commodity price level disturb creditor-debtor relationships.
   (a) What advantage might be cited in advancing the price level from a relatively low point to some previous level when a large number of debts were contracted?
4. How is gold mining affected by fluctuations in the general commodity price level?

C. What four factors have you learned about thus far that cause changes in the general commodity price level?

1. Identify the devaluation of the dollar with one of these factors.
2. Identify the silver purchasing program with one of these factors.
3. Show what other factor might offset the effects of 1 and 2 above.
4. What factor may be identified particularly with confidence or lack of confidence in the government?
5. What is inflation?
   (a) Explain its dangers.
   (b) How might inflation get started?

D. What three plans have you learned about that aim to stabilize the general commodity price level?

1. Show why international bimetallism might work satisfactorily, while national bimetallism probably would not.
2. Explain in general terms what is meant by the commodity dollar.
3. What arguments may be cited for and against a managed currency?

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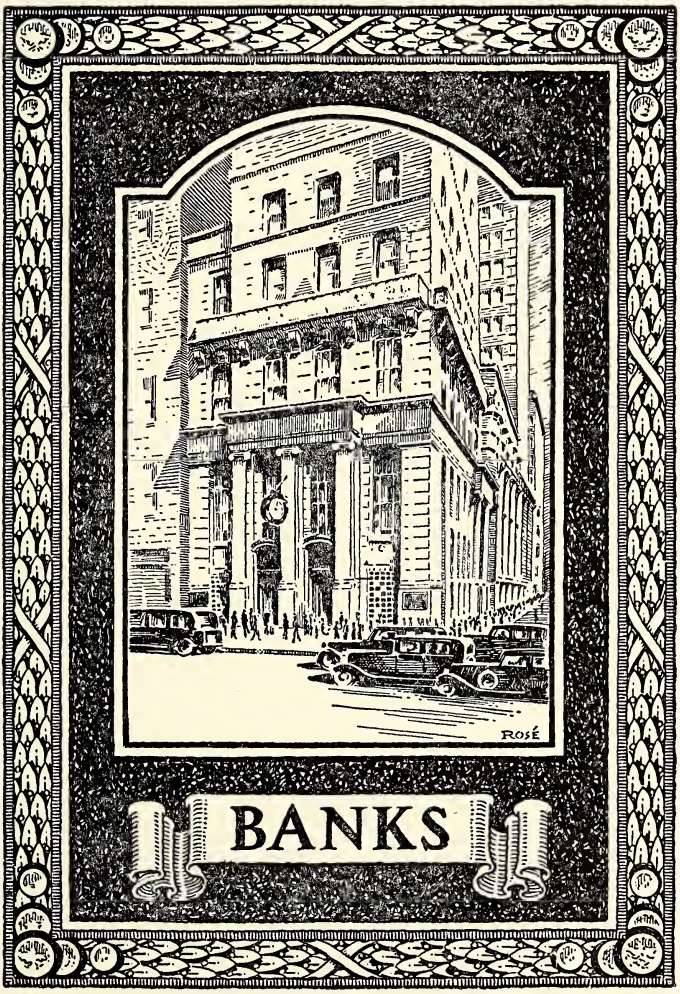
CHAPTER VI



CHAPTER VI

Banks

UNIT 1.—KINDS OF BANKS AND INSTRUMENTS OF CREDIT

Observations and Discussions.

In our general survey of the community, we noted two different kinds of banks. The first one mentioned was a *commercial bank;* the second, a *mutual savings bank.* A commercial bank is a profit-making corporation with stockholders, a board of directors, officers, and so forth. Its primary purpose is to serve the industrial and commercial interests of the community by receiving deposits subject to check, and by making loans for short periods of time to supplement private capital.

Commercial banks may be either *national banks* or *state banks.* National banks receive their charters from the national government and are under Federal jurisdiction; state banks, as the name indicates, receive their charters from the state governments and are under state jurisdiction. There are really forty-nine different sets of laws governing our banks. Each of the forty-eight states has laws governing the state banks, and the Federal government has its laws governing the national banks. It would take several good-sized volumes, therefore, to point out all the differences that exist. In general, it should be noted, however, that national banks are subject to somewhat more rigid regulations than are the state banks. Then again, all national banks must belong to a national network of banks known as the *Federal Reserve System.* Just what this entails will be considered in another chapter. State banks may be admitted to the system upon meeting the requirements specified for membership.

1. Refer to Case 35. Discuss the viewpoint of Mr. McAdoo as here set forth.

> **Think:** The following objections to our banking system have been raised: great diversity in the banking laws; low standards because of competition between state and Federal systems; incompetence because of ease with which banks in some states may be organized; inadequate and infrequent bank examinations in many states.

A *mutual savings bank* is not a profit-making institution in the sense that it aims to earn dividends for stockholders. In fact, it has neither stockholders nor directors. It is owned by its depositors and is managed by a self-perpetuating board of trustees, meaning that when one member dies or resigns the remaining members fill the vacancy by election. The purpose of a mutual savings bank is to provide a safe and convenient method whereby people of small means may pool their savings and receive interest consistent with maximum security. The savings of the depositors are invested by the trustees in high-grade mortgages and other securities approved by the government as appropriate for such purposes. All profits that remain, after the necessary expenses of running the bank are paid, belong to the depositors. Some of the profit may be put aside as a reserve for contingencies; the balance is declared as a dividend and is added to the accounts of the depositors. Deposits may usually be withdrawn as and when desired simply by signing a receipt and presenting a bank book which is issued to each depositor. To be sure, the bank has the privilege of requiring a thirty- to sixty-day advance written notice of a depositor's intention to withdraw funds, but this regulation is seldom invoked.

It will be seen that these two kinds of banking institutions are in reality quite distinct. Certain practices, however, make it appear that their functions overlap. A commercial bank may, for example, have a savings or *thrift department,* and offer to those opening accounts in this department the same amount of interest that a depositor in a mutual savings bank ordinarily would receive in dividends. It must not be

imagined, however, that such an account in a commercial bank is the same as a deposit in a mutual savings bank. The fundamental differences in organization and purposes between the two institutions cannot be ignored. This is not to say that funds deposited in one are necessarily any safer than

Federal Bank Control Is Urged by McAdoo; Present 49 Systems Held 'Worst in the World'

By The-Associated Press.

LOS ANGELES, Feb. 23.—A plan to put the national government behind every dollar deposited in banks as a guarantee against losses is advanced by William Gibbs McAdoo, United States Senator-elect from California.

Speaking before a group of Pacific Coast industrialists here last night, the former Secretary of the Treasury proposed to create a new Federal banking system which would eliminate the forty-nine banking systems now in vogue.

"I favor, if necessary," he said, "a constitutional amendment that would put the sole power over banks in the United States into the hands of the Federal Government."

It may be possible, he added, to achieve this objective without enacting a constitutional amendment, but there must be legislation, he said, which will reorganize the banking system so it will be "safe for a man or woman to put money in a bank and be able to get it out when necessary."

Describing the credit structure of the United States as a "disgraceful failure," Mr. McAdoo said he knew nothing "worse in the whole world than the American banking system."

The reason behind this situation, he said, was the existence of forty-nine separate banking practices, all independent of one another. These are the systems in the forty-eight States and the national banking system. Imperfections run through the whole structure, he said.

"Through legislation of the national government, I am in favor of a constitutional amendment to deprive States of the power of organizing banks and to make the Federal Government the sole ruler and arbiter in banking.

"When that is done, public confidence will be restored, hidden money will come out of its hiding place and the national credit structure will be fully re-established."

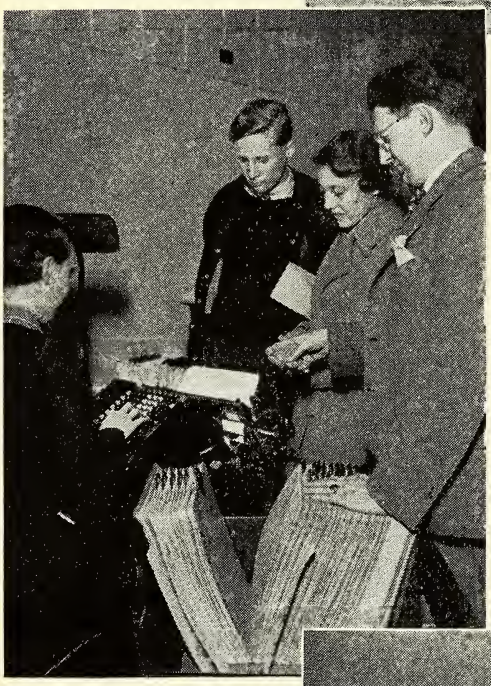
He said that in 1913, when he was Secretary of the Treasury, an effort was made to accomplish such a step, but "it was the combined opposition of bankers of the United States that stopped us."

CASE 35 *The New York Times.*

those deposited in the other. The safety of a bank does not depend upon the mechanical arrangement of its organization nor in the avowed purpose of its existence, but upon the integrity and judgment of those who manage its affairs. It would be unfair, however, not to mention the excellent record

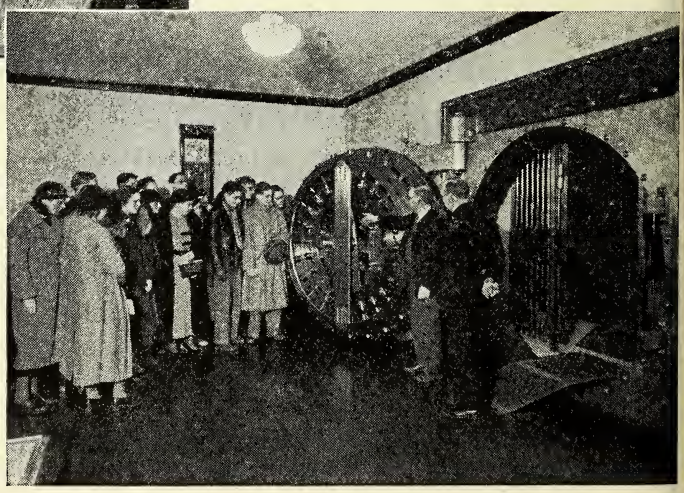
READY TO OBSERVE THE WORKINGS OF A MODERN BANK.

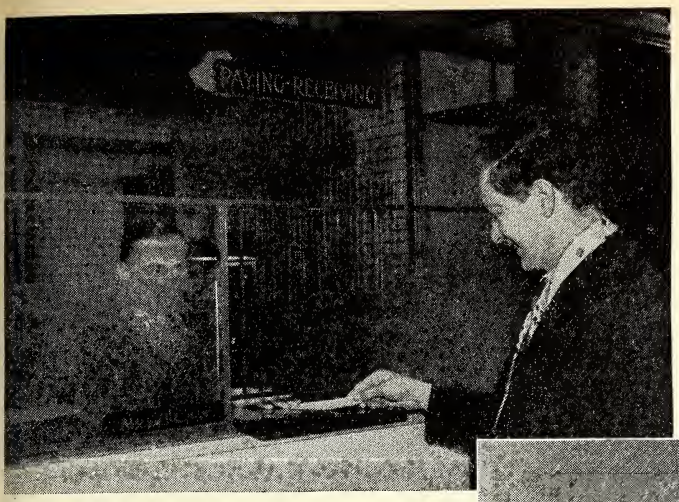
Students Visiting a Local Bank



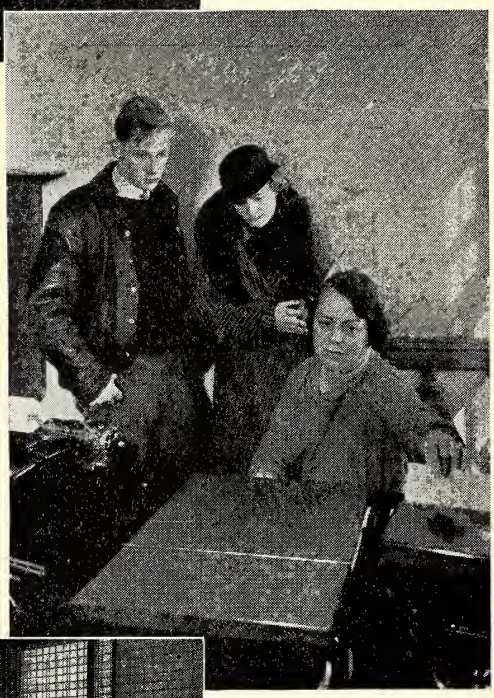
SEEING HOW THE BANK LEDGERS ARE POSTED.

OBSERVING A MODERN BANK VAULT WITH ITS INTRICATE TIME LOCKS.





LEARNING HOW MONEY IS DEPOSITED AND WITHDRAWN AND HOW NOTES ARE DISCOUNTED.



OBSERVING HOW EACH CHECK IS PHOTOGRAPHED FOR THE BANK'S PERMANENT RECORDS.

CLERKS LISTING BONDS IN THE VAULT OF A LARGE BANK.

that our mutual savings banks have made during periods of great financial strain and industrial depression.

Just as commercial banks in their savings or thrift departments seem to usurp the functions of mutual savings banks, so the latter sometimes appear to parallel the services offered by the commercial banks by accepting deposits subject to check. Here again the fundamental distinctions are not obliterated by similarity in terms. Checking accounts in commercial banks are used extensively, as we shall see, to receive loans granted by the bank and to distribute the funds according to the needs of the depositor and borrower. But, as already explained, it is not the function of a mutual savings bank to make such loans. Its checking accounts, therefore, are usually small items used mainly to settle personal and household expenses.

2. Do you see any reason why commercial banks should separate their commercial and thrift deposits, investing the latter only in the highest-grade securities?

Certain auxiliary services which are not, strictly speaking, banking functions are frequently offered by modern banks. They have come to be so closely identified with banking, however, that mention of them should be made. Either a state or a national bank may, for example, be permitted to act as an executor under a will or as a trustee under a voluntary trust created by someone who desires the bank to manage his property for him. Or the bank may act in the capacity of a trustee for bondholders' or stockholders' protective committees and in consolidations, reorganizations, liquidations, and the like. Formerly, *trust companies* performed such services, but today trust companies have added banking departments and banks have added trust departments until there is little distinction between the two institutions. Banks also frequently offer *safe-deposit* privileges. This is a plan by which customers may rent a small or large compartment in a vault. Each compartment is protected by a double lock and contains a drawer in which may be kept valuable documents. The bank provides a service which allows only the person renting

the space, or someone whom he may designate, to have access to it.

3. Make a three columnar table in your notebook. In the first column, list the kinds of banks described; in the second column, explain their functions; in the third, summarize the nature of their organizations.

4. Appoint a committee of two to arrange for the entire club to visit one of the local banks. The committee should first call at the bank, consult one of the officers, explain the nature of the club, seek permission for the proposed visit, arrange a time, and submit a memorandum stating just what the club would like to observe.

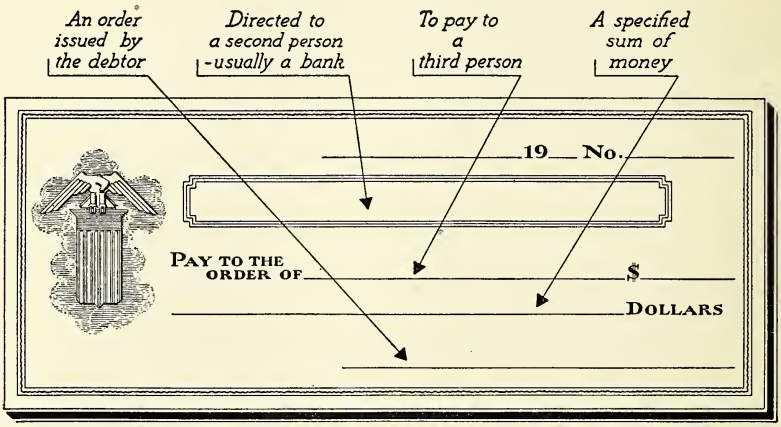
The club should observe the following: posting of accounts—deposits and withdrawals are usually posted with interesting mechanical posting machines; permanent record of checks—some banks have interesting photographic devices for this purpose; records for identification of depositors—some banks keep fingerprint records; the vault—see where the bank's supply of money is kept, and note the precautions taken against fire and theft; note the huge steel door with its intricate time lock which seals the vault at night. If possible, arrangements should be made for the club to see a bond, stock certificate, promissory note, trade acceptance, and draft.

After the visit, rule a page of your notebook once lengthwise down the center of the page, making two equal columns. List in the first column all the services usually offered by a commercial bank. Mention in the second column specific activities in the bank you observed that suggest what services that particular bank offers.

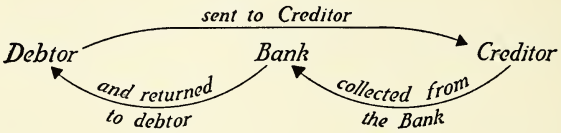
Most documents with which bankers have to deal fall under the general classification of *instruments of credit.* The common *check* is, perhaps, the most frequently used credit document. This is an order drawn by one person on another person, usually a bank, to pay a third person a specified sum. It is issued by the *debtor,* the person owing the sum, and is sent to the *creditor,* the person to whom the amount is owed. The creditor takes the check to the bank and receives the amount specified. The bank then stamps the check "paid" and returns it to the person who originally issued it. The canceled check serves as a receipt for the payment made.

A debt paid by check is really not settled until the check is accepted by the bank, that is, until the bank actually pays the sum that it is ordered to pay. If the debtor has not sufficient funds on deposit at the bank to meet the check, the

bank returns it unpaid. In order to assure the creditor that this will not happen, the debtor may first present the check to the bank to be certified. *Certification* consists of a statement on the face of the check by the bank to the effect that the bank guarantees to accept and pay the check when it is presented.

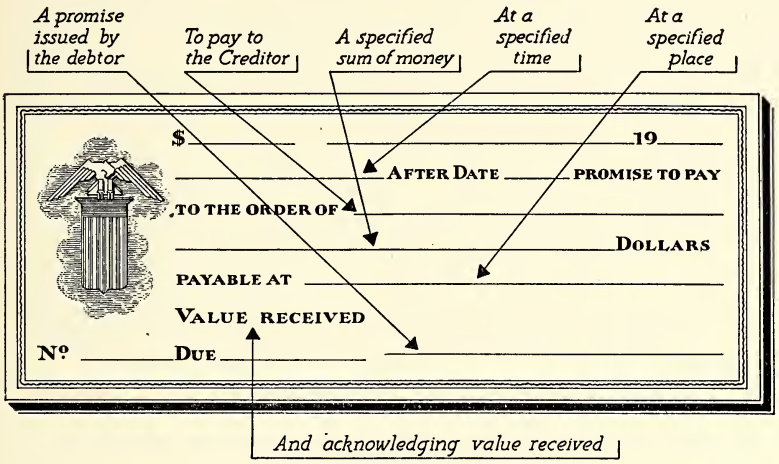


A CHECK

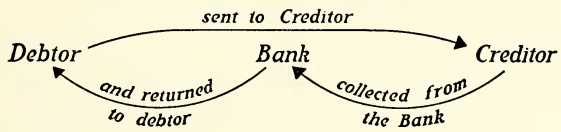


A *promissory note* is a credit document wherein one person acknowledges value received to the amount of a given sum, and agrees to pay that sum to another person at a given time and place, with or without interest as the case may be. The place designated is, under ordinary circumstances, a bank. A promissory note, therefore, is handled in the same manner as a check. It is delivered to the creditor, who may hold it until it is due and then present it to the bank for payment. When paid, it is so marked and returned to the person who originally issued it as a receipt for the payment. The creditor may, however, *discount* the note. This means that he presents it to the bank sometime before the due date and receives the face value of the note less interest. The bank then

holds the note until maturity, collects the amount due from the debtor, and returns the note as a receipt for the payment. This process of discounting we shall investigate in detail in the next unit.

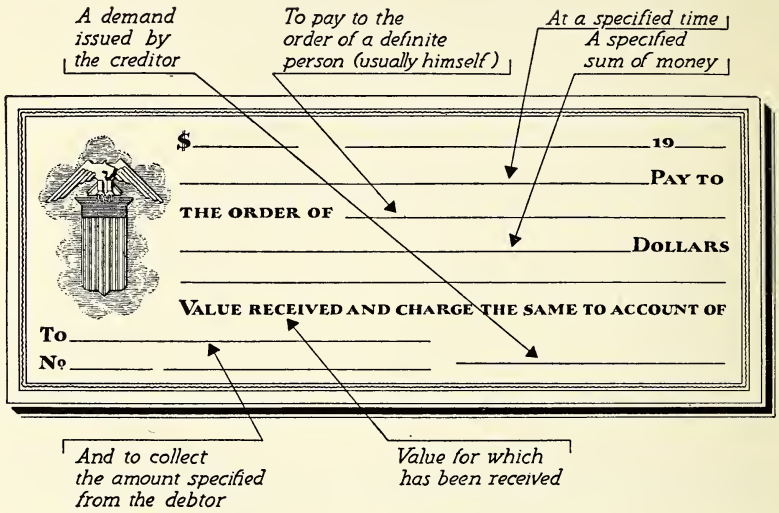


PROMISSORY NOTE

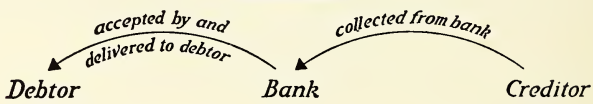


A *draft* is another common instrument of credit. This is a document issued by a creditor. It orders that a specified amount be paid and charged to the account of the debtor. Upon receiving the draft, a bank presents it to the debtor. If the debtor accepts it, he writes the word "accepted" over the face of the draft and signs his name. This serves as authority for the bank to pay the draft and charge it to the debtor's deposit account. The bank then returns the draft as a receipt for the payment. A draft is quite as legitimate a means of settling an account as a check. It is widely used abroad, and some merchants here prefer to accept drafts rather than to issue checks. Having been used widely as a means of collecting overdue items and to prod delinquent

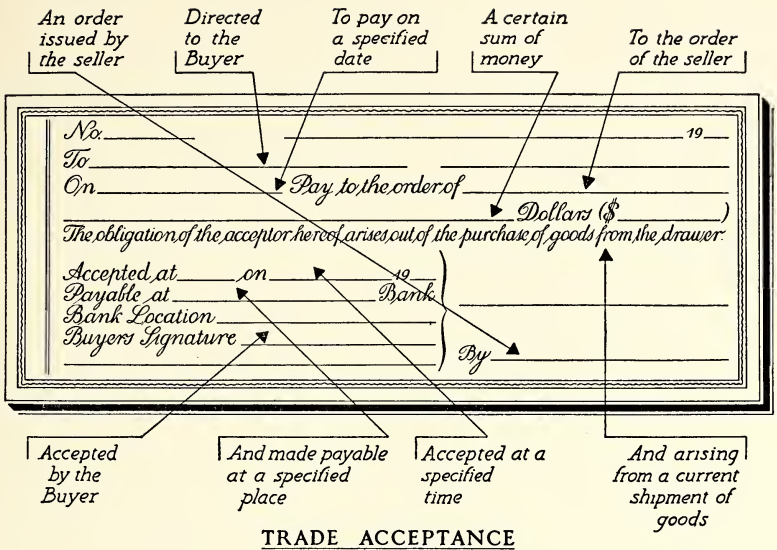
debtors, however, the draft is frequently regarded with disfavor.



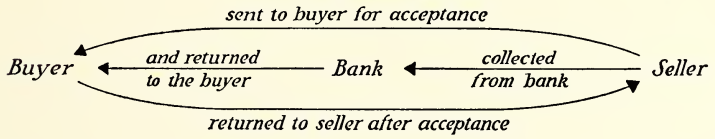
A DRAFT



A *trade acceptance* is similar to a draft except that it always arises from a current shipment of goods. It is handled, however, more like a promissory note. The value received, acknowledged by the purchaser on the trade acceptance, is the value specified on the bill, or, more properly called, the invoice for the goods. The buyer usually receives the trade acceptance with the invoice, signs the acceptance, and returns it to the seller, who collects it in the same manner as a promissory note is collected. Sellers like this way of having their accounts settled because otherwise they have only their book records to show what is due them for merchandise shipped. Book accounts are, of course, always open to possible claims for shortages and defective goods and are not discountable in regular commercial banks. Trade acceptances, on the other hand, settle the accounts except for the actual transfer of funds, and are discountable.



TRADE ACCEPTANCE



A *bond* is an instrument of credit. It is an acknowledgment of indebtedness different from a promissory note or a trade acceptance in that the indebtedness is for a longer period. This at once makes apparent the distinction between a bond and a stock certificate, the latter being, as you already know, evidence of a financial interest in some sort of joint venture—in other words, it is an instrument that is very different from a bond, which is, for practical purposes, a loan.

5. Prepare a two columnar table in your notebook. In the first column, list the names of all the instruments of credit described. In the second column, describe their uses.

UNIT 2.—THE FUNCTION OF DEPOSIT

Observations and Discussions.

From the standpoint of the frequent and varied contacts with the public, commercial banks concern us most vitally.

Consider first their function of receiving deposits subject to check. A bank receives deposits, let us say, in the form of money. The bank cash account is charged, the money is placed in the vault, and the individual depositors are credited. Checks are then used by the customers in payment for goods and services. Persons receiving checks seldom cash them; they deposit them in a bank. Checks are simply the means, then, of authorizing a bank to charge the account of one customer and to credit that of another. The fact that a check may be drawn on one bank and deposited in another does not alter the situation, because, as we shall see in the next chapter, *clearing houses* act to bind all banks together in the matter of debiting and crediting depositors' accounts.

Checks, being used as money, make it unnecessary for the bank to keep in its vault actual money equal to the full amount of its deposits. Some money, of course, is always needed, but experience proves that if a reasonable amount is kept in the vault for immediate over-the-counter use, and if an amount equal to from 7 to 13 per cent of the deposits is kept within easy access, the bank is perfectly safe. Very seldom under normal conditions do enough people all require cash at one time to exceed this *reserve*. The difference between this reserve and the full amount of the deposits may be invested by the bank in such ways as are deemed best and approved by law.

The workings of a modern bank appear complicated when described by words alone. If, however, we occasionally take a few moments and actually perform in the classroom some of the operations that are daily taking place in thousands of banks throughout the country, the procedures will be seen to be surprisingly simple. The first such demonstration to organize has to do with bank deposits.

1. Appoint a committee of two to take charge of a club demonstration showing the operation of deposit accounts. Copy in your notebook the statement and accounts prepared by the committee. Alter the statement and fill in the accounts as the demonstration proceeds.

On the day of the demonstration, place the following statement and tables on the blackboard:

A NEWLY FORMED BANK READY TO START BUSINESS

STATEMENT

Resources		*Liabilities*	
Reserve and cash on hand.	$34,000	Capital stock	$40,000
Real estate	4,500	Deposits	.....
Furniture and fixtures	1,500	Notes	.....
Stocks and bonds	.....	Undivided profits	.....
Loans and discounts	.....	Surplus	.....
	$40,000		$40,000

The Bank's Cash Account

Debits	Credits

Customers' Deposit Accounts
(Six tables like this)

Debits	Credits

Obtain some green paper, if possible, and cut 30 sheets to the size of paper money. Write on each sheet the kind of money represented by the paper, and place on each the denomination $5,000. Distribute the 30 sheets *unequally* among six members of the club.

Prepare six folded sheets of white paper representing bank books.

Arrange for one member of the committee to act as a bank teller, and the other as bookkeeper.

Members of the club having the papers representing paper money now come forward one by one and make deposits.

The teller in each case accepts the deposit and issues to the customer a bank book with the amount of the deposit recorded in it.

As each deposit is made, the bookkeeper opens a customer's account by crediting to the customer the amount of the deposit. At the same time, the bank's cash account is charged with the same sum.

After the six deposits have been made, bring the bank state-

ment up-to-date by adding up the debits in the bank's cash account and altering the "Reserve and cash on hand" item in the statement accordingly. Then total all the credits on the customers' accounts and insert this sum under "Deposits." Now prove the statement by altering the sum of the resources and the sum of the liabilities, and see that they balance.

At this point in the demonstration, distribute blank checks among the club members who have deposits in the bank.

Members of the club, having deposits in the bank, now issue checks to one another, presumably in settlement for goods and services. One at a time, each member then deposits the check or checks he has received. A check to be deposited must first be indorsed—that is, the person preparing the deposit must sign his name on the back of the check. (When checks are mailed, the words "For deposit" precede the depositor's signature. This prevents anyone into whose hands the check might accidentally fall from cashing it.) The teller enters the total sum of the deposit in the customer's bank book. The bookkeeper then takes the checks one by one and charges the account of the customer who issued and signed the check with the amount mentioned on it, and credits the account of the customer who deposited the check with the same amount.

2. (a) After the initial cash deposits were made, what was the balance of each customer's account? (b) What was the balance of each customer's account after the exchange of checks? (c) Did this exchange of checks alter the financial position of the bank? What did it alter?

3. (a) What was the total amount of the transactions represented by the exchange of checks? (b) Was any money necessary to consummate these transactions?

4. Do you think that all money could be dispensed with if there were but one bank, if every person had an account in this one bank, and if all payments were settled by checks drawn on this bank? Explain your answer.

5. Refer to your bank financial statement as it appears after all deposits have been recorded. (a) What is the amount of the deposits? (b) How much is the reserve and cash on hand? (c) Is it necessary for the bank to keep as reserve and cash on hand an amount equal to its deposits? Why, or why not?

6. (a) How much could the bank safely invest? (b) Assume that it invests this amount in bonds; what change would take place in the financial statement?

7. Why is it difficult for any bank to withstand a run, that is, heavy withdrawals by a large number of depositors at one time?

8. Refer to Case 36. Why would the closing of some banks cause heavy withdrawals and the possible closing of other banks?

Payments Are Begun Under Bank Insurance; First Go to Depositors at East Peoria, Ill.

Special to THE NEW YORK TIMES.

WASHINGTON, July 3.—Representatives of the Federal Deposit Insurance Corporation today began paying off depositors in the closed Fond du Lac State Bank in East Peoria, Ill. This was the first bank to fail while insured under the country-wide deposit insurance law.

The settlement marks the first time in the history of the United States that depositors in a closed banking institution have been protected against loss through a national system of deposit insurance. The Fond du Lac State Bank, an independent institution not affiliated with the Federal Reserve System, was a member of the Temporary Insurance Fund.

Mrs. Lydia Lobsiger of East Peoria was the first depositor to be paid. She received Creck No. 1, darwn on the Deposit Insurance National Bak of East Peoria for $1,250, from the Federal Deposit Insurance Corporation. She is a widow, and the $1,250 represented her entire capital.

More than 99 per cent of the individual depositors in the closed bank will receive the full amount of funds they had on deposit. The proved claims of all depositors in the Fond du Lac State Bank, up to $2,500 per depositor, are being paid.

When the corporation pays off a depositor in a closed institution, it receives an assignment of that depositor's claim against the bank. When the receiver of the bank realizes on any of the institution's assets sufficient to pay dividends, the amount allocable to these assigned claims will be paid to the corporation up to the amount advanced.

Deposits of the Fond du Lac

CASE 37

5 CALIFORNIA BANKS SHUT.

$3,556,751 Tied Up in Sacramento Valley—Iowa Takes Over 2 Banks.

SAN FRANCISCO, Jan. 23 (AP).—Ed Rainey, State Superintendent of Banks, announced that five Sacramento Valley banks closed their doors today because of heavy withdrawals, due to closing of other banks near by.

Deposits in the five banks aggregated $3,556,751 as of Dec. 31 or thereabouts. They were listed as

CASE 36 *The New York Times.*

The *Federal Deposit Insurance Corporation* was organized on September 11, 1933, under the Banking Act of 1933, to

insure the deposits of those institutions having the legal status of insured banks. This Corporation was continued under the Banking Act of 1935, and a permanent insurance fund was established at that time. The stock of the Corporation is held entirely by the United States and by the twelve Federal reserve banks. The shares are without par value and are not entitled to voting rights or dividends. The Corporation is managed by a board of three directors, one of whom is the Comptroller of the Currency and two of whom are appointed by the President with the consent of the Senate.

All members of the Federal Reserve System are insured banks. Any state non-member bank may become an insured bank on application to, and examination by, the Corporation. Assessments are payable by insured banks at the rate of 1/12 of 1% of their deposits per annum. The maximum amount of the insured deposit of any depositor is fixed at $5,000.00.

The corporation is authorized to establish a separate fund for mutual savings banks. If and when such separate fund is established, the corporation is authorized to establish a lower assessment rate for mutual savings banks.

9. Refer to Cases 36 and 37. Discuss the merits of deposit insurance.

Think: Those in favor of deposit insurance say: it creates confidence and makes bank runs less likely; it brings money out of hoarding; and because it is practically impossible for an outsider to judge the character of institutions, those who make possible the banking business—the depositors—should not be the losers because of misplaced confidence in a bank, the choice of which could not really be ascribed to an error of judgment on their part. Says Roger W. Babson in *Washington and the Revolutionists*, p. 10, "Bankers go to Washington stating that the act is unfair to the bank stockholders, directors, and officers. The Administration fully admits it, but replies: 'You bankers have had your day; now let the depositors have their day.' "

Those who are not in favor of deposit insurance say: it makes unnecessary the use of care and skill by banks, since their deposits are guaranteed; it makes good banks responsible for the losses of poor banks, making more likely the elimination of the former than the latter; it makes all banks equally safe for depositors and hence relieves the public of responsi-

bility for the choice of banks; it puts the burden of maintaining sound banking upon government regulation, thereby taking it from the public, which should bear a part of it; and finally, by the elimination of the element of the bank's character in the depositor's choice of a bank, the competitive appeal is shifted to other and lower standards, such, for example, as liberality in making loans.

UNIT 3.—BANK LOANS

Observations and Discussions.

1. Appoint a committee of two to carry on a club demonstration showing how bank loans are made.

One committee member may act as bank teller, and the other as bookkeeper. Rule a page of your notebook into six equal divisions. In the upper left-hand space, put the words "Original Statement," and opposite this, in the upper right-hand space, place the statement as it appears on the board when the demonstration starts. In the middle left-hand space, explain the nature of the first loan as set forth by your committee, and just opposite place the statement as first altered by your committee. In the lower left-hand space, explain the nature of the second loan, and opposite it place the statement as altered for the second time.

On the day of the demonstration, place the following statement on the blackboard:

Resources

Reserve and cash on hand	$ 20,500
Real estate	4,500
Furniture and fixtures	1,500
Bonds	163,500
Loans and discounts	.....
	$190,000

Liabilities

Capital stock	$ 40,000
Deposits	150,000
Undivided profits	.....
Surplus	.....
	$190,000

Prepare two blank promissory notes and hand them to two different members of the club.

Prepare a folded paper to represent a bank book, and green paper, as in the last demonstration, to represent: four $1,000 bills, nine $100 bills, nine $10 bills, and two $5 bills.

The club member holding the first promissory note wishes to borrow approximately $5,000 in cash for one month. The interest rate is 6% per annum.

He prepares and signs the promissory note for $5,000, and presents it to the bank teller.

The bank teller computes the interest, deducts it from the face value of the note, and hands the customer the *proceeds* in cash.

The bookkeeper deducts the proceeds from "Reserve and cash on hand," adds the face value of the note to "Loans and discounts," and places the interest under "Undivided profits."

The club member holding the second promissory note wishes to borrow approximately $5,000 for one month, and wishes to have the proceeds credited to his deposit account. The interest rate is 6% per annum.

He prepares the note and presents it to the teller.

The teller computes the interest and records the amount of the proceeds on a bank book and hands this to the customer.

The bookkeeper adds the face value of the note to "Loans and discounts," the proceeds to "Deposits," and the interest to "Undivided profits."

2. (a) Under what conditions might a customer prefer to make a loan in cash rather than have the proceeds deposited to his account? (b) Which do you think is the more customary procedure? Why?

3. (a) Did any money change hands in the process of making the second loan? (b) Is it correct to say in this case that the bank loaned money? How would you describe the transaction? (c) Can a bank's deposits increase without any money being deposited? How? (d) Can a customer be granted a loan without receiving any money? How? (e) How might the loan be used by the customer without any money changing hands?

4. (a) Refer to the "original statement" in your notes. If all the depositors attempted to withdraw their funds at once, could the bank satisfy all such demands immediately? Under normal conditions, is the position of the bank a sound one? Why, or why not? (b) What

would the bank have to do in order to pay all of its depositors? Suppose that the market price of the bonds had depreciated 25% in market value since their purchase by the bank; could all the depositors be paid?

5. A bank is said be in a *liquid position* just to the extent that it can quickly convert its resources into cash. Does the original statement or the statement as first altered reveal a more liquid condition? Explain.

6. Can a bank make more profit by making a loan in accordance with the first plan recorded in your notes—that is, by advancing the proceeds in cash—or can it make more profit by the second plan—that is, by crediting the proceeds of the loan to a deposit account? Prove your conclusion by constructing bank statements of your own.

> **Think**: Assume that a bank wishes to keep 10% of its deposits as reserve, and that its financial statement shows just that condition. If it advances the proceeds of a loan in cash, it must replace the cash, presumably, by sales from its bond account. It thereby loses the income from securities that are valued at an amount equal to the total proceeds of the loan. But suppose the bank places the proceeds of the loan to the credit of a customer's deposit account. It then increases its deposits by the amount of the proceeds of the loan, and must, therefore, increase its reserve 10% of this sum in order to maintain its desired ratio mentioned above. To get this sum, the bank, presumably, would have to realize from its bond account an amount equal to only 10% of the proceeds of the loan. In both cases, the bank receives the same amount in discount.

In actual practice, of course, banks do not make loans in any one way; some loans are made by the purchase of securities, some by advancing cash to borrowers, and some by crediting the proceeds of a loan to a borrower's deposit account. Usually, however, those who discount notes are customers of the bank granting the accommodation; they plan to pay out the proceeds of a loan by checks, and therefore want to have their deposit accounts increased rather than to receive a payment in cash.

7. It is said that a banker "is impelled by two counteracting motives, profits and safety." Explain this by reference to ratio of reserves to deposits, market price of securities, and liquidity of investments.

8. (a) Compare the original statement in your notes with the statement as first altered. A certain amount of cash has been taken from what the bank can spend and given to a borrower who can spend it.

BANK RESERVES SEEN MOUNTING TO HIGHER PEAK

Present Total, About 50% Above Legal Needs, Held the Basis for 20 Billion Credit.

Close followers of money and credit trends are convinced that aggregate reserve balances of reporting member banks will mount well above the $4,000,000,000 level within the next fortnight, it was indicated in discussion of the situation today.

Should reserve balances register another increase approaching that of the $85,000,000 disclosed last week, the total would be carried substantially beyond the indicated aggregate this week.

Reserves of member banks carried against deposits in the week ended July 18 last had reached the hitherto unprecedented total of $3,987,000,000.

At that level, the ever-mounting aggregate gave the banks a record-breaking total of more than $1,900,000,000 in "excess" reserves. In short, approximately 50 per cent of total reserves represented funds over and above legal requirements. Of the surplus reserves, about $508,000,000 was indicated as credited to New York City institutions.

Huge Credit Base.

Return to banks of approximately $1,500,000,000 in "hoarded" currency which is outstanding would, it is pointed out, tend to expand tremendously the free balances of the banks with the Reserve. The indicated excess reserves, if the accepted formula is applied, provide the basis for an expansion of $19,000,000,000 to $20,000,000,000 in member bank credits.

This phase of the situation is one that the conservative element among economists view with no little concern. They regard it as tantamount to a "powder barrel" waiting only for someone to light the fuse. Moreover, it might be stated that some of the more liberal minded among the banking element feel that federal authorities and the Reserve would face a difficult task in attempting to restrain any serious credit expansion based on such premises once it got under way.

Opposition which the Federal Reserve campaign for credit expansion

New York World-Telegram.

CASE 38

What does this amount to? Has total *purchasing power* been increased? Why, or why not? (b) Compare the statement as altered by the first loan with the statement as altered by the second loan. Has total purchasing power been increased? It is said that a bank creates *deposit currency*. Explain this.

Think: Purchasing power means potential ability to buy; that is, having in one's possession money or its equivalent, so that when wants are felt, the money or its equivalent may be exchanged for the things or services wanted. The question at issue is whether the loan made in the manner described actually created purchasing power that did not exist before the loan was made, or whether it simply transferred purchasing power from one agency to another. The possibility that, while in the possession of the bank, the money is less likely to be spent than when in the hands of the borrower is irrelevant. The question involves only the ability to buy, not the actual buying.

9. (a) How will the creation of deposit currency affect prices? (b) As a condition affecting prices, how might a reduction of bank loans more than offset a relatively large increase in the amount of money in circulation? (c) Why did the devaluation of the dollar offer the possibility but not the certainty of advancing the price level?

10. Refer to Case 38. Why should conservative economists regard this situation as a powder barrel?

Think: Reason out the following sequence: (a) excess reserves, (b) loans, (c) deposit currency, (d) prices, (e) inflation, (f) social effects.

Conclusions.

A. What kinds of banks are there in the United States?

1. Explain the difference between a commercial bank and a mutual savings bank.
   (a) In what respects do the services they render frequently overlap?
      (1) What objections to this condition can be cited?
2. Name all the different kinds of services that a commercial bank may render.
   (a) What instruments of credit are handled in the course of rendering these services?
      (1) What is the difference between a bond and a stock certificate?
      (2) What is the difference between a check and a draft?
      (3) What is the difference between a promissory note and a trade acceptance?

3. What justified criticism may be directed against our whole banking structure?

B. What is the function of deposit?

1. What is the difference between checks and money?
2. Show how banks increase the efficiency of money.
   (a) What dangers grow out of this system?
      (1) How does deposit insurance add a factor of safety to the situation?

C. In what ways may a commercial bank make loans?

1. Show how deposit currency is created.
   (a) Show the effect of deposit currency upon the general commodity price level.

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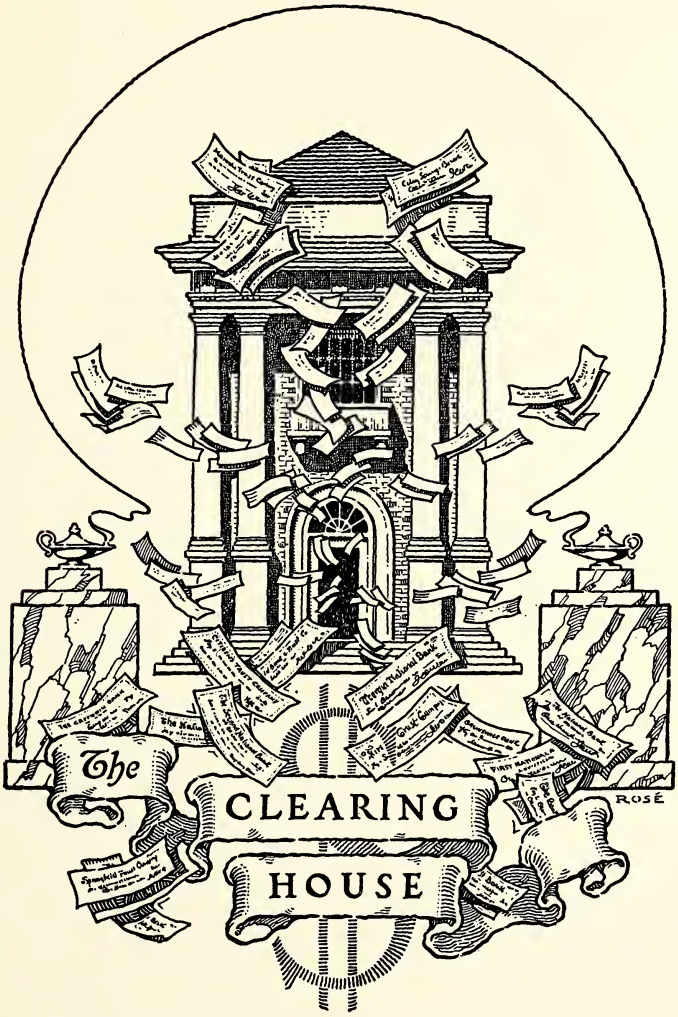
CHAPTER VII



CHAPTER VII

The Clearing House

UNIT 1.—THE FUNCTIONS OF A CLEARING HOUSE

Observations and Discussions.

1. Refer to Case 39. A clearing house has two functions. The first is suggested in this case study. Out of what sort of organizations may clearing houses develop? What, then, is one function of a clearing house?

Bankers Favor Proposal For More Clearing Houses

The American Bankers Association has received reports of action toward the organization of a large number of clearing houses among banks from many parts of the country, following the distribution several days ago of the association's proposal to transform existing county and district bankers' associations into closer-knit organizations.

Francis H. Sisson, president of the association, has expressed to President Roosevelt, on behalf of the organization, its cordial support of constructive efforts to restore conditions. The association's clearing-house proposal was made through the State bankers' associations in every State.

CASE 39

The New York Times.

2. Appoint a committee of two to find out if there is a local clearing house in your community, and if so to arrange for a visit by the club. The committee should consult a local banker. If there is a clearing house near-by, find out where it is located and the name of the secretary. Call upon the secretary, explain what is wanted, and ask permission on behalf of the club to witness the clearing of checks. If permission is granted, arrange the day and time and report to the club accordingly.

As you observe the clearing house at work, note as accurately as possible, under the following headings, what you see taking place: (a) arrival of messengers, (b) balancing of accounts, (c) exchange of checks, (d) final settlements.

3. A check for $5.00 is deposited in Bank *A* drawn on Bank *B*. (a) Trace the transactions that are involved in this deposit as follows:

The check is first credited to the customer's account in Bank *A*:

Customer's Account

Debits	Credits

Bank *A* then charges the bank on which the check is drawn:

Account with Other Bank

Debits	Credits

Bank *B* receives the check and credits the bank in which it was deposited:

Account with Other Bank

Debits	Credits

Bank *B* then charges its customer's account:

Customer's Account

Debits	Credits

(b) What financial relationship has this transaction brought about between the two banks? (c) How has it affected the total deposits of Bank *A*? (d) of Bank *B*?

4. Suppose that at the same time a check for the same amount is deposited in Bank *B* drawn on Bank *A*. (a) In a manner similar to that suggested above, trace the transactions that are involved. (b) When both of these deposits are considered, will any money change hands? Explain. (c) When both checks have been returned to the banks on which they were issued and have been paid by those banks, how are the total deposits of Bank *A* affected? (d) of Bank *B*?

5. The second function of a clearing house is suggested in question 4. What is it?

6. Can you identify the procedure witnessed at the clearing house with the situation suggested in question 4?

UNIT 2.—THE OPERATION OF CLEARING CHECKS

Observations and Discussions.

The main function of a clearing house is that of clearing checks. In the course of a day's business each bank receives checks drawn on neighboring banks, and these checks must be collected. It was once the custom in many cities for each bank to make its own collections by sending a messenger every

morning to all the other banks in the community. Accordingly, in a city of ten banks, ten messengers would each make a maximum of nine calls every day. How much simpler to have all the messengers meet at one central point and there exchange their checks! However, a plan such as this takes care of only the local checks. There is still the problem of

Students Observing the Operations of a Local Clearing House.

collecting the checks drawn on out-of-town banks. This second question introduces one of the functions of the Federal Reserve System, which will be treated in the next chapter. For the present, our investigation is centered upon local clearings, but we shall see, in due course, that the same practices that are used locally are followed in nation-wide clearings as well. The operation of clearing checks takes place so rapidly that it is impossible for an outsider to follow all the movements in detail. A club demonstration will enable everyone to see exactly what happens and to appreciate what an important role this institution plays in the economic life of the community.

1. Appoint a committee of three to conduct a club demonstration of a clearing house.

Copy the forms placed on the board and fill them in as the demonstration proceeds.

Collect five or six blank checks from each of five different banks in the community, explaining in every case the use to which they are to be put. Banks are unwilling to give their blank checks to strangers unless the circumstances are understood.

Divide the club into two groups. One group represents the banks—two individuals for each bank. The two representatives of each bank sit together and label their desks with the name of the bank that they represent by conspicuously displaying one of its blank checks. The other group represents the people of the community who ordinarily carry on business transactions with one another. Each person naturally has an account in one of the banks, and should have in his possession, therefore, some of the blank checks of the bank in which he has an account.

The committee chairman sits in front of the room and acts as the clearing house chairman. The other two committee members may each assist one of the groups in case everything is not understood.

Deposited in Bank	*Checks drawn on bank:*					*Total Credits*
	A	B	C	D	E	
A						
B						
C						
D						
E						
Total Debits						(1)

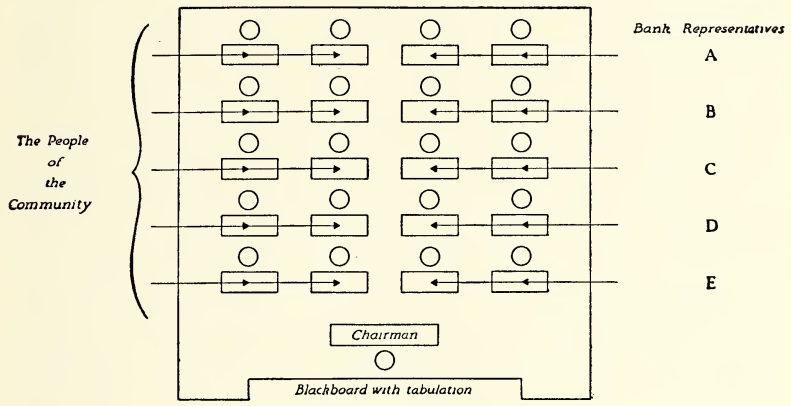
(1) *The sum of the debits must equal the sum of the credits*

Bank	*Due Clearing House* *Difference if Debits exceed the Credits*	*Debits* *Bottom row of last tabulation*	*Credits* *Last column of last tabulation*	*Due Bank* *Difference if Credits exceed the Debits*
A				
B				
C				
D				
E				
Totals	(3)	(1)	(2)	(4)

(1) *must equal* (2) —— (3) *must equal* (4).

On the blackboard in the front of the room are placed the forms shown on the preceding page ready to be filled in (in place of the letters *A*, *B*, *C*, etc., should be placed the names of the banks).

Everything is now in readiness for the demonstration. The club room looks like this:



The people of the community issue checks to one another in any amounts desired. It is best, however, for the sake of easy figuring that the amounts be in even dollars and something less than one hundred dollars. One person issues a check to another, for example, for the amount of $5.00, presumably for the settlement of some debt; to another person he issues a check for $10.00; to a third, a check for $25.00; and so forth. In each case, he hands the check to the person to whom it is issued. Everybody in the community does the same until the supply of blank checks is exhausted.

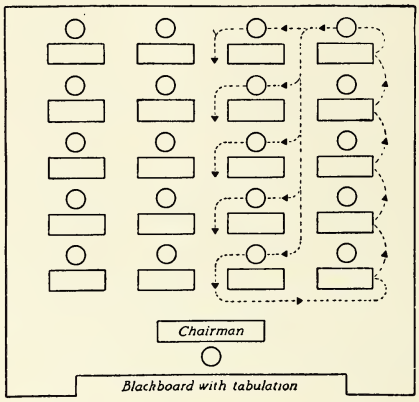
Each person in the community takes the checks which he has received and deposits them in the bank where he has an account.

Each bank now sorts the deposited checks according to the bank upon which they are drawn, and places each lot of checks in an envelope labeled as follows:

"Checks deposited in ..... Bank, drawn on ..... Bank. Amount $....."

Beginning with Bank *A* and followed by Banks *B*, *C*, *D*, and *E*, the amounts on the envelopes are read off to the chairman as follows: "Deposited in Bank *A*: checks drawn on Bank *B*, $.....; checks drawn on Bank *C*, $.....; checks drawn on Bank *D*, $....."; and so forth. The chairman records these figures on the first form as they are called. Then Bank *B* reports, and the chairman records these figures; then Bank *C*, and so forth.

One representative from each bank now takes the envelopes that have been prepared by his bank, and, passing around the room in the manner indicated in the following sketch, delivers the envelopes to the other bank representatives who remain seated. In this way, all checks drawn on Bank *A* are delivered to that bank, all checks drawn on Bank *B* are delivered to Bank *B*, and so forth.

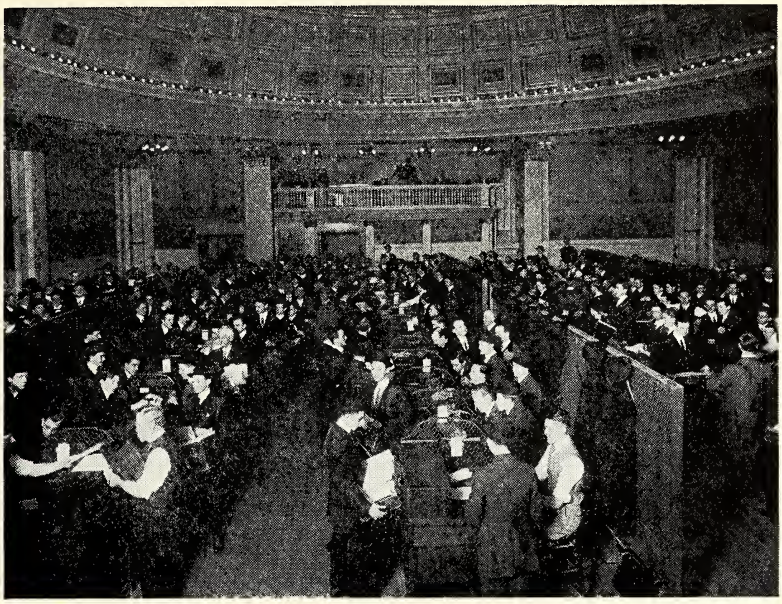


While this is being done, the chairman prepares the second blackboard form.

First, the debit and credit columns are tabulated. The debit entry opposite *A* is the total of the vertical *A* column of the first form recorded at the foot of the column. The debit entry opposite *B* is the total of the vertical *B* column recorded at the foot of the column, and so on. The credit entry opposite *A* is the total of the *A* horizontal column recorded in the extreme right-hand column of the first form. The credit entry opposite *B* is the total of the *B*

horizontal column recorded in the extreme right-hand column of the first form, and so on.

Second, the "Due the Clearing House" and "Due the Bank" columns are filled in. If the debits entered opposite *A* exceed the credits entered opposite *A*, then the difference is entered in the "Due the Clearing House" column; if, however,



A Large City Clearing House.

the credits exceed the debits, then the difference is entered in the "Due the Bank" column. The same applies to *B, C, D,* etc.

Finally, the chairman issues clearing house checks which he can write out on plain paper for all items that appear in the "Due the Bank" column and delivers these to the proper banks. He collects checks from the other banks according to the items that appear in the "Due the Clearing House" column. The total of the clearing house checks should equal the total of the clearing house receipts.

Sometimes the balances are settled in cash. Sometimes each member bank deposits with the clearing house an amount

of money equal to the maximum amount of claims likely to be made against a bank in any one day's clearings. In such

Spending Billions Without Need of Actual Currency

How Government Borrowings and Expenditures Are Effected by System of Credit Entries and Checks

The Government during the past week floated a billion dollars worth of its securities in order to obtain money with which to meet its bills. Banks, investment houses and individuals purchased those securities. They wrote checks on their bank accounts payable to the Government.

Their bank, then, merely by a bookkeeping entry, deducted the proper sum from each purchaser's account and set it up on another page of its ledger as a credit to the Government. Or, if the bank is not a Government depositary, it notifies the local depositary bank of the amount to be credited to the Government's account, and the two banks, meeting in their clearing house association at the end of the business day, will balance off the credits each has against the other and settle the difference by changing on the books of the clearing house the sums due each other.

Little or no cash has changed hands. The whole transfer has been accomplished by the transfer of credit on the books of a single bank or clearing house association.

CASE 40

United States News.

a case, the balances may be settled by clearing house checks. At other times, balances are settled by checks on large metropolitan banks in which many of the smaller banks have accounts.

2. (a) Record the following clearing house operations, using the same method as was used in the club demonstration:

Deposited in Bank A

Checks for....	$1,322.42	on Bank *A*
Checks for....	499.32	on Bank *B*
Checks for....	532.00	on Bank *C*
Checks for....	999.88	on Bank *D*
Checks for....	1,321.00	on Bank *E*

Deposited in Bank B

Checks for....	$ 0	on Bank *A*
Checks for....	600.00	on Bank *B*
Checks for....	1,321.42	on Bank *C*
Checks for....	3,420.21	on Bank *D*
Checks for....	599.00	on Bank *E*

Deposited in Bank C

Checks for....	$ 398.42	on Bank *A*
Checks for....	3,921.11	on Bank *B*
Checks for....	199.00	on Bank *C*
Checks for....	2,111.00	on Bank *D*
Checks for....	111.00	on Bank *E*

Deposited in Bank D

Checks for....	$1,123.00	on Bank *A*
Checks for....	399.00	on Bank *B*
Checks for....	4,321.00	on Bank *C*
Checks for....	1,311.00	on Bank *D*
Checks for....	221.00	on Bank *E*

Deposited in Bank E

Checks for.....	$1,321.00	on Bank *A*
Checks for.....	1,444.22	on Bank *B*
Checks for.....	321.22	on Bank *C*
Checks for.....	1,342.12	on Bank *D*
Checks for.....	342.11	on Bank *E*

(b) What is the total volume of trading represented by the checks that go through the clearing house?

(c) Assuming that the banks settle their clearing house balances in money, how much money changes hands?

(d) Wherein does this plan make money more efficient?

3. Refer to Case 40. Show how the clearing house system makes it possible for banks to make loans by placing credits to customers' accounts and yet hold in their vaults such a comparatively small amount of money.

4. It has been said that industrial civilization has evolved from a barter economy through a money economy to a credit economy. Justify the statement.

Conclusions.

A. In this chapter you have learned that a clearing house has two functions.

1. What are these functions?

B. Explain the operation of clearing checks.

1. How does this enable a large amount of business to be transacted without the use of money?
   (a) In what different ways may clearing house balances be settled?
2. How does this enable a bank to create loans by increasing deposits?

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CHAPTER VIII

CHAPTER VIII

The Federal Reserve Bank

UNIT 1.—ORGANIZATION OF THE FEDERAL RESERVE SYSTEM

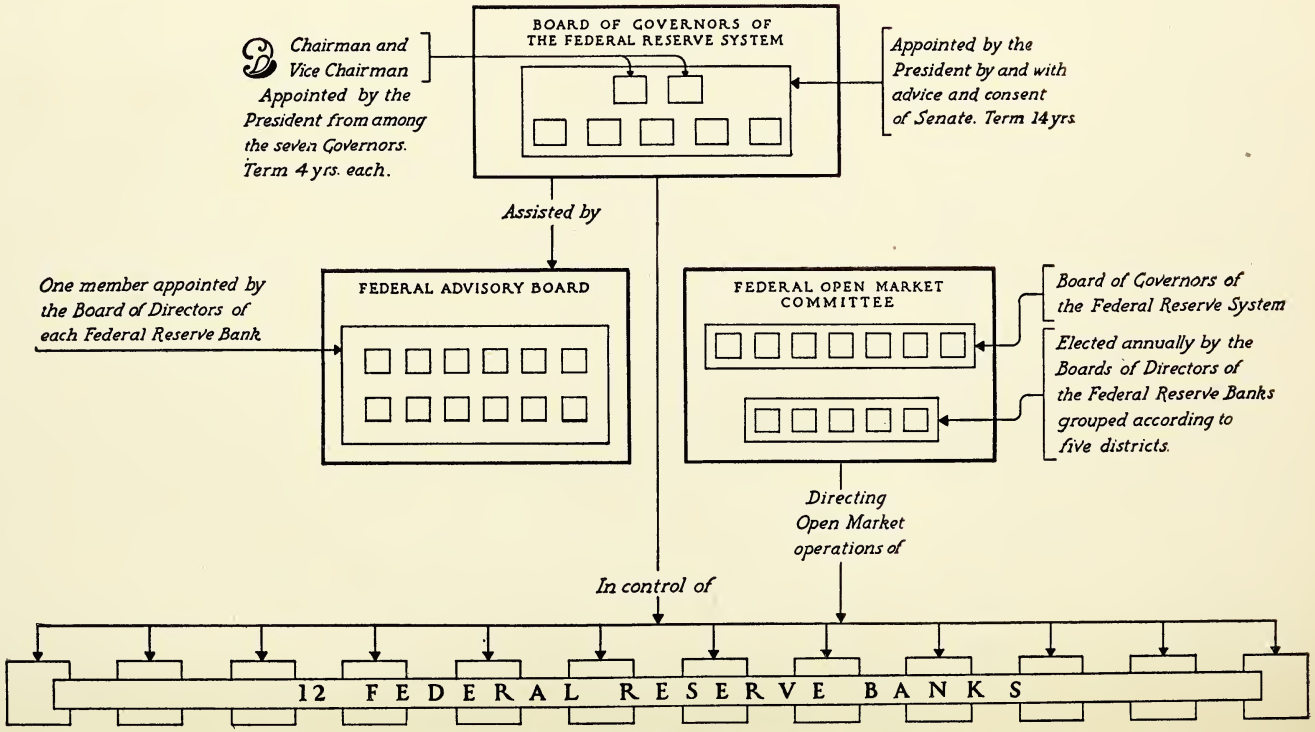
Observations and Discussions.

We have heard the American banking system characterized as the "worst in the world" (Case 35). Certain it is that the record of our bank failures during the early years of the recent economic depression cannot be reviewed with any measure of pride or satisfaction. On previous occasions, however, definite weaknesses in our banking structure have been rectified by new laws, and today we are again attacking our banking problem by legislation which it is hoped will make impossible a repetition of the hardships so recently experienced.

Just previous to the Civil War, American banking was, perhaps, in the most chaotic period of its history. Those years are now referred to as the era of "wild cat" banking. The National Banking Act of 1863, which brought into being our present twofold system of state and national banks, put an end to this dark chapter of American banking. Indeed, this Act brought about such a marked improvement that little further change was thought necessary. But the panics of 1879 and 1907 brought banking problems again to the fore. In 1908, a National Monetary Commission was appointed to make a thorough study of our entire banking system. Five years later, as a result of the investigations and recommendations of this commission, the Federal Reserve System was established.

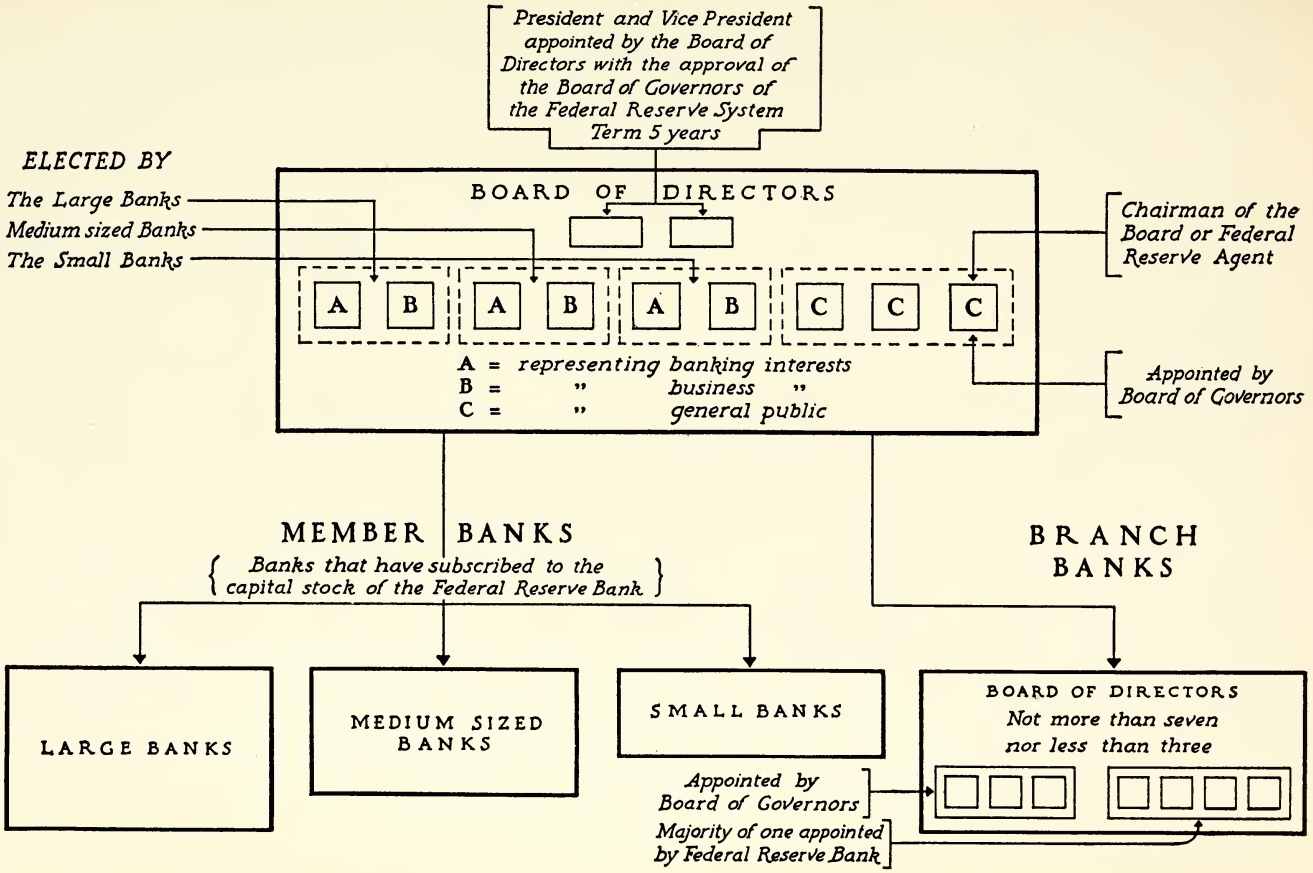
Until recent happenings, the American banking problem was again thought fairly well settled. Now a third outstanding landmark has been added to our banking legislation. The Banking Bill of 1935 places greater power in the hands of the

ORGANIZATION OF FEDERAL RESERVE SYSTEM



Each serving a territorial unit known as a Federal Reserve District

ORGANIZATION OF EACH FEDERAL RESERVE BANK



governing body of the Federal Reserve System; it establishes, as we have already seen, a permanent system of deposit insurance, and it offers the possibility eventually of inducing into the fold of the Federal System a larger proportion of the banks of the country. Thus we have moved definitely towards more centralization of authority and greater unification of our banking structure. Let us hope that we have moved away just as definitely from "the worst banking system in the world."

1. (a) According to the chart on page 136, all Federal reserve banks are under the control of what body? (b) This controlling body is made up of how many members, and how are they chosen for office? (c) How are the chairman and vice-chairman chosen? (d) How many members has the *Federal Advisory Council* and how do they obtain office? (e) Explain the composition of the *Federal Open Market Committee*. Its function is considered in Unit 2.

2. (a) Directors of the Federal reserve banks are chosen in a manner differing somewhat from the customary corporation practice. By reference to the chart on page 137, show how this is done. (b) In what way does this method introduce a measure of democracy in the management of the Federal reserve banks not found in ordinary corporations? (c) What is the difference between a branch Federal reserve bank and a member of the Federal Reserve System?

Federal reserve banks earn profits and pay dividends as in the case of other corporations. Annual dividends of a reserve bank are limited, however, to an amount equal to 6% of the par value of the bank's outstanding capital stock. Earnings beyond this sum go to augment its surplus, but, in the event of dissolution, are contributed to the United States Treasury.

3. By reference to both of the charts shown on pages 136 and 137, trace the extent of governmental control now existing in the Federal Reserve System.

Think: What influence has the President of the United States in the system? What arrangement helps to assure close coöperation between the Boards of Directors of the several Federal reserve banks and the *Board of Governors of the Federal Reserve System?* Study the composition of the Federal Open Market Committee. What disposition is made of profits?

4. Previous to the 1929 depression, there were about 18,000 banks in the country of which less than 7,000, or about 39%, were members of the Federal Reserve System. The Banking Act of 1935 provides that after 1941 no bank having deposits of $1,000,000 or more shall be entitled to deposit insurance unless it is a member of the Federal Reserve System. How may this provision work to bring about greater unification of our banking system?

5. Refer to Cases 41 and 42. To what extent do the recent changes in our banking laws bring these recommendations closer to realization?

6. Is there any more reason for government control of the banking business than there is for similar control of, say, chain grocery stores?

FOR CENTRAL BANK, RESERVE WIDENING

Executive Council of Bankers' Association Asks Passage of Revised Glass Bill.

STUDY COMMISSION URGED

Report Submitted at Augusta by Col. Ayres Also Calls for Curb on Loans to Officers.

Special to THE NEW YORK TIMES.

AUGUSTA, Ga., April 12.—Establishment of a central bank by the Federal Government, with the twelve Federal Reserve Banks as branches and with State chartered commercial and mutual savings banks admitted into the Federal Reserve System, was recommended here today at the close of the Spring meeting of the executive council of the American Bankers' Association.

CASE 41

DICKINSON FAVORS UNIFIED BANK PLAN

Assistant Commerce Secretary Tells Savings Group It Is First Step in Reform.

ALSO WOULD LIMIT SIZE

Dr. Giannini Warns Thrift Is in Peril—Kingman Says That Confidence Is Rising.

John Dickinson, Assistant Secretary of Commerce, former law professor at the University of Pennsylvania and one of President Roosevelt's inner circle of advisers, advocated a unified banking system, limitation of the number and size of banks and better separation of types of credit handled by different kinds of banks in an address here last night.

He spoke at the annual Eastern Savings Conference dinner of the Savings Division of the American

CASE 42

The New York Times.

UNIT 2.—FUNCTIONS OF A FEDERAL RESERVE BANK

Observations and Discussions.

1. If the club is located in or sufficiently near a Federal reserve city, appoint a committee of one to arrange a club visit to the Federal reserve bank. The committee should write to the Federal reserve bank ten days or two weeks before the proposed visit, explain the nature of the club, request permission to visit the bank, and state the day and time that the club would like to make the proposed visit. It is possible in some Federal reserve banks to see an interesting motion picture explaining the functions of the Federal Reserve System. It would be well to mention this picture in the letter and request that if possible it be shown to the club.

At the Federal reserve bank you will witness activities that are suggestive of the main functions of the bank. Make notes of these and later write in your notebook a brief description of these activities, classifying them as far as possible according to the main functions of a Federal reserve bank explained below.

The Federal reserve banks serve four main purposes: they provide central depositories for bank reserves, facilitate the collection of out-of-town checks not cared for by the local clearing houses, provide an elastic currency, and act as fiscal agents of the United States government.

2. Refer to Case 43. Which of the above functions is here suggested?

All banks, as we have seen, must maintain a certain reserve; that is, they must at all times have available a certain percentage of their deposits in lawful money of the United States. Members of the Federal Reserve System must keep their reserves on deposit in the Federal reserve bank serving the district in which they are located. Each Federal reserve bank is, then, a sort of central reservoir of funds from which member banks may draw when in need. Furthermore, through the Board of Governors of the Federal Reserve System, all twelve reservoirs are, so to speak, piped together. The funds from one centralized supply, then, may temporarily be used in another. Thus, if an extraordinary demand for funds arises in any one part of the country, the contingency can be met. The plan not only adds stability to the whole banking system, but there is increased efficiency as well, for each bank can, with

RESERVE BALANCES DROP $105,000,000

A drop of $105,000,000 in reserve balances of member banks of the Federal Reserve System from the high record of $4,020,000,000 a week ago, was reported yesterday by the system in its report for the week ended Wednesday. The excess of reserves over requirements is now approximatly $1,800,000,000, against the peak of about $1,900,000,000 last week.

CASE 43

OLD NOTES MEETING NEED FOR CURRENCY

Special to THE NEW YORK TIMES.

WASHINGTON, March 18.—The country's currency demands have been met since the banking holiday by the issuance of Federal Reserve notes, backed by at least 40 per cent gold, and national bank notes, backed by government bonds, rather than through the use of the new Federal Reserve Bank notes, according to Treasury figures today. The latter are issued on the collateral of eligible paper and government obligations.

CASE 45

BANKERS SEE DOOM OF CLEARING HOUSES

Break-Up of Local Groups Is Expected to Follow Rush to Federal Reserve.

LICENSE POLICY A SPUR

Refusal to Allow Sectional Alliance Apply as Unit Is Blow to Associations.

By this action one of the last defenses of the clearing houses against the Federal Reserve System's assumption of clearing-house functions was broken down. Bit by bit in recent years the Federal Reserve System has absorbed more and more of the operations formerly undertaken by the clearing houses. Intercity clearings are now passed through the Reserve Banks, and balances resulting from interbank clearings are settled on the books of the Federal Reserve Banks. According to some authorities, the Federal Reserve could as easily and cheaply perform for the member banks the last remaining functions of the clearing houses.

CASE 44

Conference at Capital.

Special to THE NEW YORK TIMES.

WASHINGTON, Oct. 30.—Developments today gave every indication that the administration is seeking to avoid bringing on international monetary warfare when it puts into effect its program of gold-purchasing by the Reconstruction Finance Corporation in the world markets.

The understanding today was that the RFC would sell its notes to the Federal Reserve Banks, which are to act as its fiscal agents. The Federal Reserve agents would then carry on operations abroad.

CASE 46

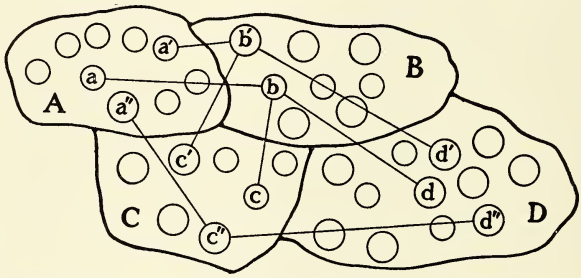
The New York Times.

the utmost safety, conduct its business on a smaller percentage of reserves than would have been prudent under the old arrangement of decentralized units.

3. If, however, there are, as in March 1933, abnormal demands for currency all over the country at one time, what will happen?

4. Refer to Case 44. What function of the Federal reserve bank is here suggested?

If the old system was inefficient in the matter of reserves, it was little less than chaotic in its method of collecting out-of-town checks. A bank in one community would have a so-called *correspondent bank* in some other community. All checks deposited in the first bank payable in the territory covered by the second bank would be sent to this second bank

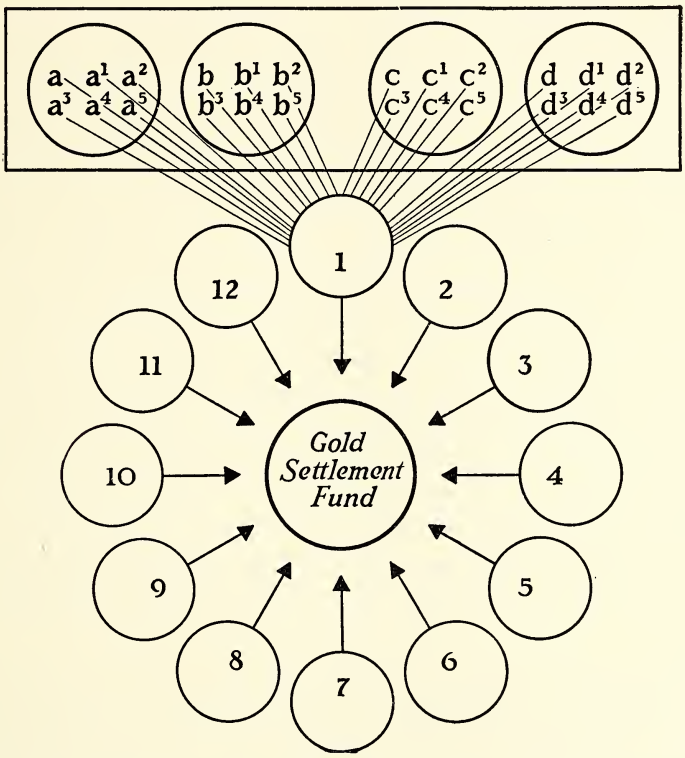


THE OLD SYSTEM OF CLEARING CHECKS. A, B, C, D = clearing house communities; a, b, c, d, etc. = individual banks.

for collection, and likewise all checks deposited in the second bank payable in the territory covered by the first bank would be sent to this first bank for collection. A whole network of correspondent banks grew up in hit or miss fashion, leading to great confusion. Not only would checks often take very circuitous routes in finding their way back home, but the matter of charges to customers for out-of-town collections gave rise to much rivalry and many misunderstandings. Each Federal reserve bank now acts as a district clearing house for its member banks; nonmember banks use the system indirectly by clearing through some near-by member bank. Unlike the local clearing houses, the checks are exchanged by mail. In the New York Federal Reserve Bank, an entire floor is given over to this work, and clerks are at work day and night receiv-

ing and mailing checks and altering the accounts of individual member banks accordingly.

The clearing house function of the Federal reserve banks does not end with district clearings. There has been established in Washington, D. C., what is known as the *gold settlement fund,* originally created by a deposit from each of the



THE NEW SYSTEM OF CLEARING CHECKS. Rectangle = Federal reserve district (not repeated in the case of every Federal reserve bank); circles in the rectangle = local clearing house communities; a, b, c, d, etc. = local banks; 1, 2, 3, 4, etc. = Federal reserve banks.

Federal reserve banks. This is used as the basis of interdistrict clearings. Every day, each Federal reserve bank telegraphs to Washington its charges against each of the other Federal reserve banks. The checks follow by mail. The figures for the clearings are compiled in Washington, and each bank is credited and debited as the case may be. The gold

settlement fund always remains intact, but its ownership constantly changes according to the daily charges and credits against and in favor of the individual reserve banks.

5. By reference to the accompanying sketches, explain the old and new system of clearing checks.

6. Refer to Case 45 (page 141). What function of the Federal reserve bank is here suggested?

When industrial conditions are active, more currency is needed than when conditions are less active. A currency that will increase and decrease according to such needs is called an elastic currency. The *Federal reserve notes* fulfill this requirement. They get into circulation by a process known as *rediscounting*. When business is active, there is a demand upon member banks for loans, and many promissory notes are discounted. A member bank may, after discounting a promissory note, indorse that note, and rediscount it at the Federal reserve bank at a somewhat reduced rate. The proceeds may be used to build up the member bank's reserve deposits, but, if the member bank requires currency to meet the demands arising from an increased volume of trade, it may receive the proceeds in the form of Federal reserve notes. In due course of time, when trading is less active, the loans are paid, and the Federal reserve notes are retired by being canceled as fast as they find their way back to the Federal reserve banks as deposits.

Each Federal reserve bank is required by law to set aside security dollar for dollar against the reserve notes that it issues. The security may be in the form of gold, rediscounted notes, or other forms specified in the law.

Federal reserve banks are primarily bankers' banks. They do, however, have some dealings directly with the public, and their actions may exert a far-reaching influence in our economic life. By advancing the *rediscount rate,* a Federal reserve bank may force its member banks to advance, in turn, their discount rate to individual customers. This discourages borrowing, it checks the increase of deposit currency, slows down advancing prices, and puts a brake on speculation. How effective such an increase in the rediscount rate will be

depends upon the financial condition of the member banks. If their financial condition is such that they have to rediscount, then the increased rediscount rate will be effective; if not, then the member banks may go along quite independently of the dictates of the Federal reserve bank. In such an event, however, the reserve bank has another weapon. By selling large blocks of desirable securities, it creates such a demand for funds that the member banks find themselves forced to rediscount in order to provide the necessary currency. The selling of securities in this way, known as *open market operations,* brings the Federal reserve banks in direct contact with the public. Open market operations are determined by the Federal Open Market Committee, and must be followed by the Federal reserve banks.

It might be argued that by reducing the rediscount rate and buying large blocks of securities, the Federal reserve bank would create a demand for loans and would place the member banks in a position to satisfy this demand. This, then, would tend to build up the supply of deposit currency and increase the price level. As a matter of fact, however, the process does not necessarily work both ways, as was discovered during the recent depression. It was found at that time that a low discount rate does not in itself create a demand for loans. Industrial conditions may be in such a depressed condition that few wish to borrow at any price.

7. If a customer discounts a promissory note of $5,000, payable in three months at 6% interest, and the member bank immediately rediscounts this note at 5%, how much profit does the member bank make by the transaction?

As fiscal agent of the United States government, the Federal reserve banks are required to receive funds from the United States Treasury and to hold such funds subject to checks issued by the Treasury Department. The enormous fiscal operations of the government during the war period were largely handled by the Federal reserve banks in this way.

8. Refer to Case 46 (page 141). How were the Federal reserve banks here used as fiscal agents of the government?

UNIT 3.—OPERATIONS OF A FEDERAL RESERVE BANK

Observations and Discussions.

This is a statement of a national bank before the passage of the Federal Reserve Act in 1913.

Resources		*Liabilities*	
Cash	$ 32,000	Capital	$200,000
Bonds	238,000	Surplus	25,000
Deposits in other banks	5,000	Deposits	50,000
	$275,000		$275,000

Under the old system, each bank had to maintain its own legal reserves, either in its own vault or in the form of deposits in some other bank subject to immediate call, hence the large cash reserves and the "Deposits in other banks."

A series of skeleton bank statements, arranged in two main columns, appears on the four following pages. In the column entitled "The Member Bank," certain alterations in the above statement are suggested. These alterations correspond to the changed financial status of the above national bank when it becomes a member of the Federal Reserve System, complies with the regulations of that system, and uses the district Federal reserve bank as a depository for reserve funds, for rediscounting promissory notes, and as a source for additional currency when that is needed.

In the column entitled "The Federal Reserve Bank" appears another series of skeleton bank statements in which may be recorded the reserve bank's transactions with the above member national bank. It should be kept in mind that there are, of course, many member banks for each Federal reserve bank. The Federal reserve bank's statement should in reality, therefore, reflect its transactions with all of its member banks—not simply with one as here outlined. The present procedure will simplify the example, however, and at the same time will serve to illustrate all the chief relationships of a Federal reserve bank with its member banks.

The Member Bank

The member bank is required to become a member of the newly created Federal Reserve System; and, therefore, to comply with the regulations, it subscribes to the stock of the Federal reserve bank an amount equal to 6% of its own capital and surplus. This it takes from cash.

Resources		*Liabilities*	
Cash	$———	Capital	$200,000
Bonds	238,000	Surplus	25,000
Deposits in other banks	5,000	Deposits	50,000
Stock (reserve bank)	———		
Total	$———	Total	$———

The Federal Reserve Act as amended (1917) recognizes only one form of legal reserves—a member bank's deposit in its Federal reserve bank. In small cities this reserve is 10% of the deposits. The member bank satisfies this requirement by withdrawing its funds deposited in other banks, and depositing these funds in the Federal reserve bank.

Resources		*Liabilities*	
Cash	$ 18,500	Capital	$200,000
Bonds	238,000	Surplus	25,000
Stock	13,500	Deposits	50,000
Deposits (reserve bank)	———		
Total	$———	Total	$———

The Federal Reserve Bank

The Federal reserve bank is supplied with working capital by its member banks. All national banks are required to be members of the Federal Reserve System. State banks may become members.

Resources		*Liabilities*	
Cash	$———	Capital	$———
Total	$———	Total	$———

The former scattered reserves, now being collected in 12 large reservoirs, as it were (there being 12 reserve banks), are readily available in large amounts. The total reserves need not be so great, therefore, as under the old system.

Resources		*Liabilities*	
Cash	$———	Capital	$ 13,500
		Deposits	———
Total	$———	Total	$———

The member bank's statement is not affected.

The Federal reserve banks do not keep in their vaults all the reserve money deposited by the member banks. Like other banks, they invest it. The law requires them to keep a reserve of 35% of their deposits. The reserve bank invests $8,000.

Resources		*Liabilities*	
Cash	$———	Capital	$13,500
Investments	———	Deposits	5,000
Total	$———	Total	$———

The member bank's cash deposits increase $10,000 and it makes good its 10% reserve with the Federal reserve bank by depositing with that bank an additional $4,000.

Resources		*Liabilities*	
Cash	$———	Capital	$200,000
Bonds	238,000	Surplus	25,000
Stock	13,500	Deposits	———
Deposits (reserve bank)	———		
Total	$———	Total	$———

While this member bank is receiving deposits, others may be paying out large sums. Centralization of reserves gives the latter the benefit of the operations of the former.

Resources		*Liabilities*	
Cash	$———	Capital	$13,500
Investments	8,000	Deposits	———
Total	$———	Total	$———

The member bank now has heavy demands made upon it to discount notes. $60,000 is discounted and added to the accounts of customers. For simplicity interest is not considered in the statements.

Resources		*Liabilities*	
Cash	$ 24,500	Capital	$200,000
Bonds	238,000	Surplus	25,000
Loans	———	Deposits	———
Stock	13,500		
Deposits (reserve bank)	9,000		
Total	$———	Total	$———

The Federal reserve bank's statement is not affected.

The member bank, needing its $24,500 to pay out to customers, makes good its legal reserve in the Federal reserve bank by rediscounting $20,000 of its commercial notes. In this way the member bank may offer further credit accommodations to its customers.

Resources		*Liabilities*	
Cash	$ 24,500	Capital	$200,000
Bonds	238,000	Surplus	25,000
Loans	60,000	Deposits	120,000
Stock	13,500	Rediscounts	———
Deposits (reserve bank)	———		
Total	$———	Total	$———

The Federal reserve bank rediscounts the notes offered it by the member bank, and places the proceeds to the credit of the member bank's account. For simplicity, interest is not considered in the statement.

Resources		*Liabilities*	
Cash	$14,500	Capital	$13,500
Investments	8,000	Deposits	———
Discounts	———		
Total	$———	Total	$———

Anticipating heavy withdrawals, the member bank now rediscounts an additional $10,000 of commercial notes, and takes this in the form of Federal reserve notes in order to have plenty of money on hand.

Resources		*Liabilities*	
Cash	$———	Capital	$200,000
Bonds	238,000	Surplus	25,000
Loans	60,000	Deposits	120,000
Stocks	13,500	Rediscounts	———
Deposits (reserve bank)	29,000		
Total	$———	Total	$———

The Federal reserve bank increases both its discounts and its notes in circulation by the amount of the discounts offered it by the member bank.

Resources		*Liabilities*	
Cash	$14,500	Capital	$13,500
Investments	8,000	Deposits	29,000
Discounts	———	Federal reserve notes in circulation	———
Total	$———	Total	$———

$25,000 is now withdrawn by the depositors of the member bank. Some of the Federal reserve notes are therefore needed as currency. Thus they get into circulation.

Resources		*Liabilities*	
Cash	$———	Capital	$200,000
Bonds	238,000	Surplus	25,000
Loans	60,000	Deposits	———
Stock	13,500	Rediscounts	30,000
Deposits (reserve bank)	29,000		
Total	$———	Total	$———

The Federal reserve bank's statement is not affected.

In the course of business, $20,000 is returned in cash deposits to the member bank, and the member bank redeposits this in the Federal reserve bank.

Resources		*Liabilities*	
Cash	$ 9,500	Capital	$200,000
Bonds	238,000	Surplus	25,000
Loans	60,000	Deposits	———
Stock	13,500	Rediscounts	30,000
Deposits (reserve bank)	———		
Total	$———	Total	$———

Of this $20,000, $10,000 happens to be in Federal reserve notes. The Federal reserve bank therefore retires these notes.

Resources		*Liabilities*	
Cash	$———	Capital	$13,500
Investments	8,000	Deposits	———
Discounts	30,000	Federal reserve notes in circulation	———
Total	$———	Total	$———

1. Copy the statements appearing on pages 147–150 in your notebook, filling in the statements as indicated.

Conclusions.

A. In this chapter you have learned about the organization of the Federal Reserve System.

1. The system is under the control of what body?
   (a) How many members?
   (b) How are they chosen?
2. What is the Federal Advisory Council?
   (a) How many members?
   (b) How are they chosen?
3. What is the Federal Open Market Committee?
   (a) How are its members chosen?
   (b) What are open market operations?
   (c) How may the decisions of the Open Market Committee influence our economic life?
4. What exceptions to customary corporation practice may be noted in the organization of a Federal reserve bank?
   (a) Who are the owners of the Federal reserve banks?

B. What are the four main functions of the Federal Reserve System?

1. What is the advantage of centralized reserves?
2. Contrast the present method of clearing intra-district checks with the old method of using correspondent banks.
   (a) Explain the function of the gold settlement fund.
3. What so-called elastic currency is issued by the Federal reserve banks?
   (a) What is the advantage of an elastic currency?
4. How may a Federal reserve bank act as fiscal agent of the United States government?

C. You have learned that many of the operations of a Federal reserve bank center about the process of rediscounting.

1. Explain this process of rediscounting.
   (a) What is the significance of the rediscount rate in our economic life?
   (b) How may the rediscount privilege be used to bring elastic currency into circulation?
2. What becomes of the funds deposited with the Federal reserve banks by the member banks?

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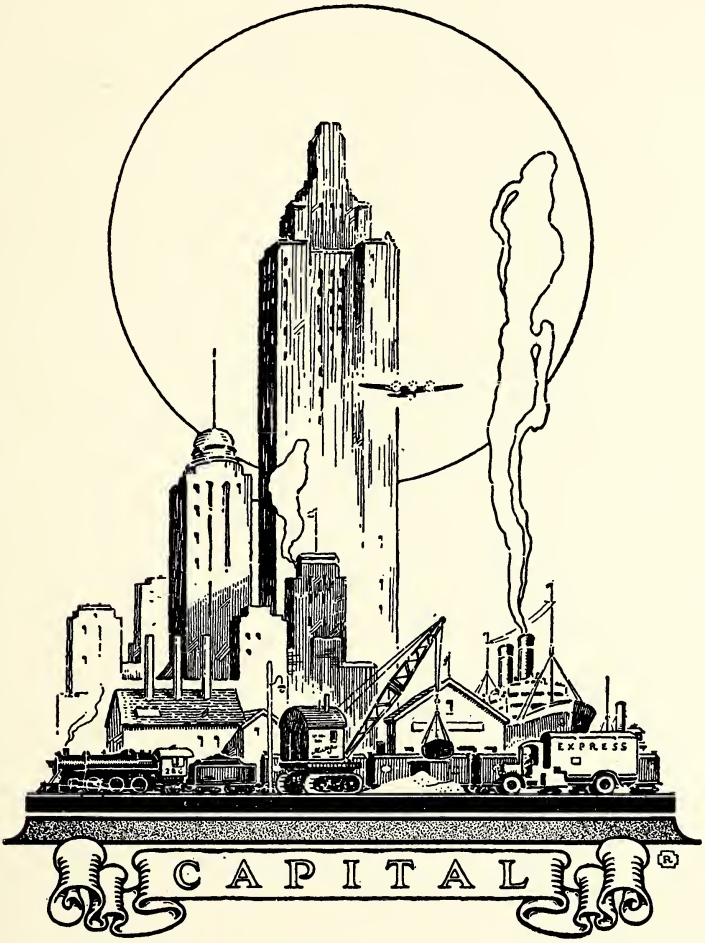
CHAPTER IX



CHAPTER IX

Capital

UNIT 1.—THE SIGNIFICANCE OF CAPITAL

Observations and Discussions.

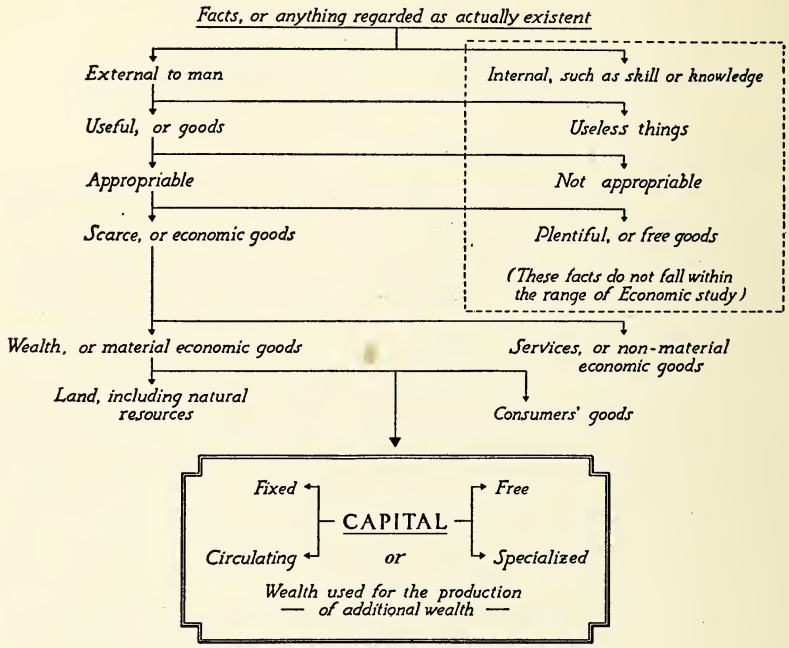
Without *capital* man would still be in the root-grubbing age—a time when, unaided by any kind of tool, man devoted every ounce of his energy to the mere task of maintaining his existence. Whoever first conceived the idea of attaching a stone on the end of a stick brought capital into the world. Aided by this formidable tool, man's labors were made infinitely more effective. Not only was more and better food obtainable, but more time was available for the other tasks of living. Steam shovels, hydraulic presses, railroad trains are all nothing but an elaboration, however great, of this primitive form of capital, because they too do nothing more than facilitate man's labor. But so greatly have these and other similar modern aids enlarged upon the powers of man's body mechanism, and so intricate have become the processes by which they are created and put to use, that we are inclined to forget that their fundamental economic significance is exactly the same as that of the first crude tool.

We need now to consider how capital is related to other things falling within the scope of economic investigation, and its significant position in modern industrial life.

1. By reference to the following chart and explanation, determine in each of the following cases whether the item mentioned is or is not an economic good (If it is not, state why. If it is, state whether it is a non-material or material economic good. If the latter, state whether it should be classified under land, consumer goods, or capital. If it is capital, state whether it is free or specialized capital and whether it is fixed or circulating): (a) the skill of a surgeon, (b) mosquitoes, (c) a

beautiful sunset, (d) fresh air under ordinary circumstances, (e) a waterfall, (f) a steam shovel, (g) gold in a manufacturing jeweler's factory ready to be made into an ornament, (h) a machine for repairing automobile tires, (i) bread on the table ready to be eaten, (j) the services of a lawyer.

The PLACE OF CAPITAL IN ECONOMIC STUDIES



In determining what things are useless, we are not concerned with the merits of the particular objects wanted—that is, whether they are considered wise or foolish possessions, good or bad ones. To be sure, such matters are of the utmost importance in determining human welfare, but unfortunately man's wants are not always guided by what is good for him or for society. In our determination of usefulness, therefore, we are concerned only with the question of whether or not the article is wanted. If it is, it is useful; if it is not, it is useless.

In the case of bonds, mortgages, and shares of corporation stock, there is a difference between common speech

and technical language. In ordinary business conversation, such instruments are called capital; even in financial statements they are referred to as such. But strictly speaking, they are not capital; rather, they represent capital. Money in the form of a piece of paper, the value of which is negligible, simply represents power in exchange. You may exchange it for capital, but in itself it is not capital. Metallic money is capital only insofar as its metal content is concerned, but we have already seen that the metal content of money is not a reliable measure of its power in exchange. It may represent an amount of capital far in excess of the value of the metal of which it is made. A bond has been described as a document evidencing indebtedness. The capital it represents may be a distant railroad, mine, or office building. Also, in the case of a mortgage the capital it represents is the property that has been pledged to secure the loan. Should we make a list of all the capital in the country, we would include all forms of material economic goods except land. We certainly should not include money, bonds, mortgages, and stock certificates, because so doing would give us a double count. These are called, therefore, *representative goods.*

Capital which is relatively general in its applicability—such as a factory building used to house various kinds of industries, or a machine tool, such as a lathe, which is suitable for use in the production of various commodities—is called free capital. On the other hand, capital which is restricted in its use, such as, for example, a specially constructed machine for polishing roller-bearings, is specialized capital. Capital which is relatively durable, depreciating only gradually as it wears out, is known as fixed capital. Factory buildings, manufacturing machinery, and so on, would fall within this category. Capital which is absorbed in the value of the finished product, such as raw materials, is called circulating capital.

2. "By increasing the money in circulation, we increase the wealth of the country." Is this true? Why, or why not?

> **Think:** What is wealth? See in the above chart on page 156 the item "Wealth, or material economic goods."

3. Refer back to Case 12 on page 42. (a) Select items among the assets of the corporation that are capital in the strict economic sense of the term. (b) Point out items that are called capital in the popular sense of the term.

4. Refer to Case 47. (a) Classify machines as you classified the items in question 1. (b) Keeping in mind what capital accomplishes, predict an ultimate effect upon the economic life of the country if the policy regarding machines suggested in Case 47 is pursued.

5. Does creating employment in itself necessarily advance the economic welfare of the people as a whole?

> **Think:** Suppose that you broke every pane of glass in the building in which you are housed; would you thereby create employment? Would you advance the economic welfare of the people as a whole?

6. The term "make-work theory" is sometimes applied to actions such as the one suggested above. Show, by reference to the make-work theory, that a war may give the appearance of spreading prosperity, whereas in reality it only lowers the economic welfare of the people as a whole.

7. Refer to Case 48. To abolish poverty from the nation, which of the following policies would you advocate: (a) Would you stimulate technology, that is, improvement in methods of production including the substitution of machine for hand labor? (b) Would you retard such improvements? (c) Would you discourage experimentation in economic organization, such as hours of labor, working conditions, wage regulation, etc.? (d) Would you encourage such experimentation? Give reasons for your decisions.

8. Refer to Case 49. (a) State whether you think that the viewpoint there expressed is sound or fallacious and give your reasons. (b) In what respect does this viewpoint agree with the viewpoint expressed by Dr. Ogburn in Case 48?

9. Refer to Case 50. Had you been at the meeting, which side of the argument would you have supported, and how would you have supported it?

10. Roundabout production is the process by which a machine is built in order to build another machine which manufactures, let us say, an automobile. What is the use of going about building an automobile in this way?

Nazis to Curb Machines As Substitutes for Men

By The Associated Press.

BERLIN, Aug. 5.—Alfred von Hodenberg, in charge of economic questions for the Nazi Labor Front, stated today that rationalization methods having in view substitution of machines for men would be prohibited henceforth.

"Never again must the worker be replaced by a machine nor a highly skilled manual laborer by an unskilled or woman laborer," Herr von Hodenberg said.

"Of course, it is impossible to get along without the machine altogether," he added.

CASE 47

SEES END OF POVERTY IN NATION OF FUTURE

Dr. Ogburn Holds Long Trend Is to Higher Living Standard, Less Disease, More Crime.

While poverty will be on the increase for several years the long-time trend is for a nation without poverty, with less disease, but with more crime, Dr. William F. Ogburn of the University of Chicago told the National Social Work Council yesterday. "After these dark years have passed," he said, "it will be possible to make great headway toward abolishing poverty."

"There are four factors that determine the standard of living," he declared. "These are population, natural resources, technology and economic organization. The greatest difficulty to be overcome in raising the level of life is the economic organization which has many serious weaknesses but which is in no way in danger of collapse unless there is another big war or revolution."

CASE 48

GERMAN LABOR FRONT FAVORS THE MACHINE

Use of Work-Saving Devices Creates More Jobs, Says Statement by Body.

Special Correspondence, THE NEW YORK TIMES.

BERLIN, Feb. 14.—Labor-saving machines do not cause poverty or unemployment. On the contrary, they create new opportunities for employment. So asserts the German Labor Front in a statement which reverses the attitude held for a century by labor in general.

The prohibition of the use of machines in certain occupations, notably cigarmaking, is declared to be merely a temporary measure designed to cover a transitional period. A failure to take advantage of machinery, it is said, would merely give other nations an advantage, and the idea that production is too great is all wrong. Germany produces too little

CASE 49

MINERS ASK SHARE IN MACHINE PROFITS

In a dramatic debate a dozen miners with seamed faces and broad shoulders told how the mechanization of the mines had cast hundreds of families into the bread-lines. Then, in an equally dramatic conclusion, President John L. Lewis called upon the mine workers to accept machinery—since they could not turn the clock back—but to demand their share of the benefits of the machines in the form of shorter hours and increased compensation. They must make the machines their allies instead of fighting them as foes.

"That is the way to handle the problem of the machines," declared Mr. Lewis. "We must see to it that we get our fair share of the advantages of genius and invention."

CASE 50

The New York Times.

11. As civilization develops, social life constantly changes. As a consequence of this change, different kinds of economic goods are wanted. What is the danger in having too great a proportion of the nation's wealth in the form of fixed and specialized capital?

UNIT 2.—THE CREATION OF CAPITAL—SAVING AND SPENDING

Observations and Discussions.

Of paramount importance is the problem of creating capital. This can be done only by saving. A day's supply of food in the hands of Robinson Crusoe represented savings —a surplus of production over consumption. When, the next day, he consumed this surplus and built a bow and arrow, he had available a tool which enabled him to accumulate more savings with greater ease and certainty. These he used while constructing shelter, making clothes, and producing many other things that increased his safety and added to his comfort. Through savings, therefore, his supply of capital was gradually augmented and his way of life made easier.

So it is in civilized life. Money, earned through labor, is exchanged for the necessities of life. When a sufficient wage is received so that all is not immediately required, some of it can be saved. There is then a surplus of production over consumption. This is ordinarily deposited in a bank, because the particular person who has saved it has no occasion immediately to use it. At the same time, someone else who is in a position to use more capital profitably goes to the bank and seeks a loan. The loan is made possible because of the deposit, a procedure that our investigations have already traced. The proceeds of the loan are used, perhaps, to construct a new machine, which, like Crusoe's bow and arrow, greatly facilitates the production of further wealth.

1. Think of some large public utility company operating in your community, for example, the light and power company, the street railway company, or the telephone company. Select some item of capital in your community that is owned by this company, as, for

example, an electric distributing plant. Now assume that some of the bonds of your local public utility company are owned by your local bank. Beginning with a depositor's savings of $1,000 in your local bank, trace step by step, according to the following outline, the relation between the depositor's savings and the creation of the observed item of capital:

A. The depositor's savings.
   1. How is the bank's cash account affected?
   2. How are its deposits affected?

B. The bank buys the public utility company bond.
   1. How is the bank's cash account affected?
   2. What item on the asset side of the bank's statement is affected?

C. The public utility company sells the bond.
   1. How is the public utility company's cash account affected?
   2. What new item appears on the liability side of the public utility company's statement?

D. The power distributing plant is built.
   1. How is the public utility company's cash account affected?
   2 What new item appears on the asset side of the public utility company's statement?

2. Refer to Case 51 (page 162). Explain why it is necessary to have a constant supply of new capital to maintain our economic structure.

3. Suppose that people spent all their earnings for consumers' goods, or, in other words, consumed all they created; what would be the ultimate result?

> **Think:** Would worn-out capital be replaced? What function does capital play in our economic life? If it all ultimately disappeared, then, what would be the result? Draw your conclusion.

It does not follow, however, that there are no limitations to the virtue of thrift. To be sure, all capital is constantly wearing out and must be replaced if our standard of living is to be maintained, and this alone requires no small amount of excess production over consumption. But too much saving offers almost as many hazards as too little. A balance is necessary.

THRIFT HABIT HELD RETARDING RECOVERY

Dr. A. L. Barach Says Feeling of Guilt at Spending in Face of Other's Need Is Factor.

Dr. Alvan L. Barach of the College of Physicians and Surgeons, Columbia University, declared yesterday that economic recovery depended on a radical change in spending and saving habits. He said he had reached this conclusion after a psychological study of depression conditions, the results of which were made public by the National Committee for Mental Hygiene.

Dr. Barach declared the nation was in the sinister grip of a habit of excessive thrift which was partly responsible for the failure of the "Buy Now" campaign of the NRA.

He said this habit, born of want and fear in the deepest period of the depression, was retarding recovery and must be broken. He added:

"It has been augmented by feelings of guilt and shame at spending in the face of the need of others, and is especially conspicuous among many of the well-to-do who are deterred from buying by mistaken notions of the moral effects liberal spending will produce upon the poor in their midst."

CASE 52

BUY NOW CAMPAIGN WITHOUT BALLYHOO BEGINS NEXT WEEK

Special to THE NEW YORK TIMES.

WASHINGTON, Oct. 1.—Under a slogan "Now Is the Time to Buy!" a campaign to persuade the public to help industry and trade in this direction will be started Oct. 9 by the NRA.

CASE 53

NEW CAPITAL DEMAND PUT AT $4,500,000,000

Industrial Conference Board Finds Big Investment Need Has Accumulated in 3 Years.

As a result of the virtual suspension of private financing, there has accumulated in the last three years a demand for $4,500,000,000 of new investment capital for producing and operating facilities, according to estimates by the National Industrial Conference Board.

CASE 51

The New York Times.

4. Suppose people spent only enough to maintain a bare existence and saved the balance of their income; do you think that this would be a benefit to the economic life of the community?

> **Think:** What would become of the savings? Who would purchase the consumers' goods that the capital helps create? Draw your conclusion.

5. Refer to Case 52. Do you think that the viewpoint of Dr. Barach is sound? Reasons.

6. Refer to Case 53. State the economic advantages and disadvantages of a "buy now" campaign.

Conclusions.

A. In what limited sense is the term "capital" used in economics?
   1. What different kinds of capital may be distinguished?
      (a) What is the difference between free and specialized capital?
      (b) What is the difference between fixed and circulating capital?
   2. What purpose does capital perform in economic life?

B. Explain the economic process by which capital is created.
   1. What part do banks play in this process?
   2. Why is saving constantly necessary to maintain our economic organization?
      (a) Can there be too much saving? Explain.
      (b) Can there be too much spending? Explain

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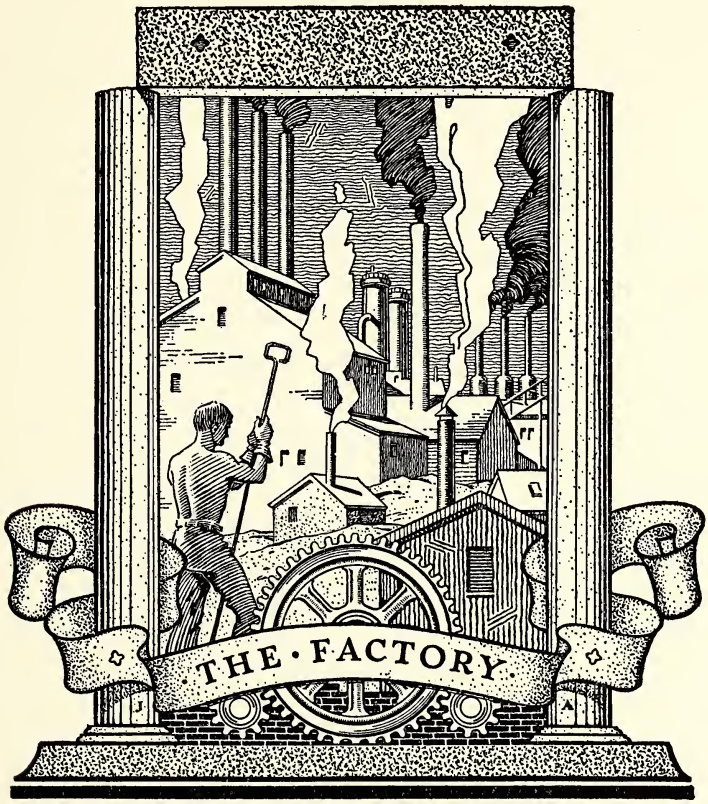
CHAPTER X



CHAPTER X

The Factory

UNIT 1.—THE AMOUNT AND KINDS OF THINGS PRODUCED

Observations and Discussions.

1. Refer to the chart, "Fundamental Relationships in Economic Life," on page xii in the front of the book. What determines the quantity of wealth or economic goods produced?

Your answer to question 1 can be reduced to four elements —called *factors of production:* land, labor, capital, and management. *Land* is understood to include natural resources of all kinds. Thus, in this technical sense, "land" embraces air, water, sunshine, mineral and oil deposits, and so forth. No amount of labor or ingenuity will create an amount of wealth in Iceland comparable to that which is produced in England because of the basic differences in the land factors of production. The people of Iceland may, of course, produce in quantities more than sufficient to meet their own needs the things afforded by their own natural resources. This surplus they may then exchange for some of the comforts and luxuries of life enjoyed in other parts of the world. Nevertheless, the ability of the Icelanders to acquire economic goods not provided by their own environment is limited by the possibilities of offering things in exchange. Trade may help them in the matter of variety, but does not release them from the fundamental limitations of quantity imposed by the land factor of production.

No matter how abundant may be the natural resources, however, a second factor of production—*labor*—is necessary to transform them into useful things. The character of this labor and how skillfully it is used determine in no small de-

gree the quantity of economic goods that can be produced. To some extent mere brawn and strength are necessary, but man has learned more and more to make his physical labor subservient to his mental labor. *Capital* is a case in point. We have already seen how greatly capital aids man's physical labors in the production of wealth, and a remarkable amount of inventive genius has been displayed in adapting it to so many uses. So important is capital that it ranks with land and labor as a third factor of production. But there is another direction in which man's mental efforts have been exerted to facilitate physical work. It is a common observation that an organized group can accomplish far more than can the same number of individuals working independently. Organization implies mental effort expressed in *management*. Management, therefore, is also an important item in determining the quantity of economic goods that are produced, and may justly be considered a fourth factor of production.

Management facilitates man's labor, in the first place, by keeping the factors of production in proper balance. A modern, well-organized factory is a monument to man's ingenuity in this regard. Owing to management, the other factors of production, land, labor, and capital are combined in just the right proportions for maximum efficiency. There is sufficient room, but no waste space; each worker is comfortably busy at some definite task, but there is no evidence of undue haste; an abundance of capital is on hand to supplement man's labor, but none is idle, except such as may temporarily be under repair or reserved for peak loads. To the industrialist this problem resolves itself into one of costs. He seldom faces any difficulty in obtaining more of any factor of production, providing the additional unit will pay for itself. If insufficient space is causing waste, he can move into new quarters; if more labor, either physical or mental, is needed, he can usually obtain it; if additional capital can profitably be used, there are financial institutions to which he can apply. Should the supply of any one factor become definitely limited, management would face the *law of diminishing returns*. This law will be considered in the next chapter be-

cause, as we shall see, it is of particular concern to the agriculturist. But this does not mean that the industrialist is exempt. The law is of universal applicability. The indus-

PLANT EFFICIENCY NOW VITAL FACTOR

Engineers Preparing to Handle Problem Created by New Working Conditions.

NO FEDERAL INTERFERENCE

Following what is reported to be a successful fight against the NRA attitude that plant improvements, looking toward elimination of wasteful procedure and speeding up of production, are not in line with the recovery program, management engineers are now preparing to handle a large volume of business under the new industrial conditions, according to leading executives in the field here yesterday.

Sharply rising prices, higher wage scales, misinterpretations of the various codes and shorter running hours are some of the factors that will necessitate measures for the elimination of waste, stricter material control, rearrangement of plant layout, better production planning methods and the simplification of all routine, according to engineers yesterday.

CASE 54

OUR POWER IS PUT AT 50 SLAVES EACH

Dr. Karl Compton Says Nation's Artificial Strength Equals That of 6 Billion Men.

SEES NO EFFECT ON JOBS

Engineering advances have made available in this country 6,000,000,000 manpower, "equivalent to fifty slaves for each man, woman and child," Dr. Karl T. Compton, president of the Massachusetts Institute of Technology, estimated last night in discussing the relation between mechanization and unemployment.

"The machine has released man from the work he had to do to go out and do new work," he said. Citing the automobile industry, he pointed out that in 1900 the horse and carriage industry employed fewer than a million workmen, while in 1930 the automobile industry employed 2,409,000, exclusive of the service industries.

The industry was directly or indirectly responsible for the employment of between twenty-five and thirty million workers, he said, pointing out that 203,000 were employed on roads in 1910 and 339,000 in 1930.

"The great problem of the engi-

CASE 55

The New York Times.

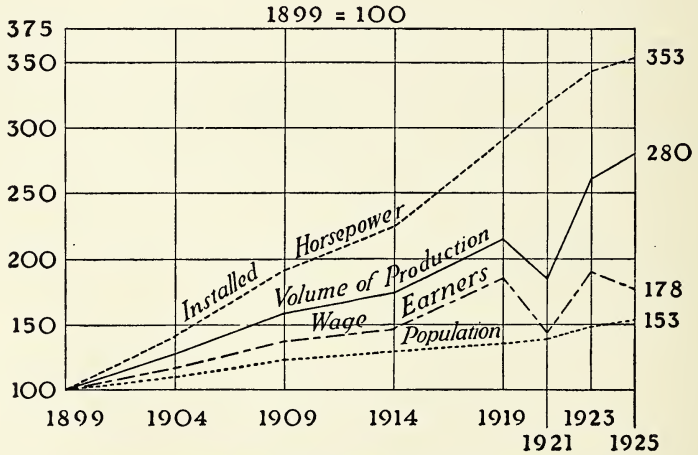
trialist simply escapes because, under ordinary circumstances, he is not handicapped by any condition of scarcity in any factor of production that he desires to increase. Mere apportioning of the factors of production for the maximum efficiency,

however, brings about some of the most serious maladjustments found in our economic life.

2. Refer to Case 54. What conditions will stimulate management to rearrange and perhaps to reapportion the factors of production?

> **Think:** If wage scales increase while interest rates remain low, what shift will take place between labor and capital? As land values rise, will more stories be added to existing buildings, or will more one-story buildings be erected?

Technological unemployment is unemployment caused by a substitution of the capital for the labor factor of production. When technological unemployment takes place, management has determined, presumably, that an increase in the capital factor and a decrease in the labor factor will reduce costs. Under competitive conditions, reduced costs result in reduced selling prices.



Growth of Manufactures, U. S., 1899–1925[1]

3. Refer to the accompanying chart. What changes in the factors of production employed in industry have taken place during recent years?

4. Refer to the accompanying chart. What is indicated as to technological unemployment up to 1923? After 1923?

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[1] National Industrial Conference Board, Inc.

5. Does an increase in labor-saving machinery necessarily mean a permanent increase of technological unemployment?

> **Think:** What will be the immediate effect upon unemployment? How will costs be affected by the introduction of the machinery? Under competitive conditions, how will selling prices be affected? How is this likely to affect the demand for the product manufactured? What may be the ultimate effect upon the demand for labor?

Conclusions to questions 4 and 5 seem to be contradictory. The fact that during the years just prior to 1929, the first year of the depression, there was considerable technological advance and substitution of machinery for hand labor cannot be denied. Furthermore, reliable sources estimate that during these years there was no small amount of unemployment. One such authority, for example, estimates the number of employees attached to non-agricultural pursuits from 1920 to 1927 as from 27,558,000 to 32,695,000, and the amount of unemployment during these same years as ranging from 1,401,000 to 2,055,000.[2] To infer that many of these workers were unemployed because of the shift from the man factor of production to the capital factor of production seems entirely reasonable.

Nevertheless, if American industry and agriculture be considered as a whole, it seems that maladjustments in our economic life far more general in scope than those caused by technological advance must be taken into account in seeking the causes of unemployment. A recent reliable study[3] estimates that our productive system as a whole was operating at only about 80% of its possible capacity in 1929. Furthermore, this study goes on to show that if the surplus capacity had been used in producing commodities needed by a large percentage of the population, the entire labor force of the country would have been needed. This would have required

[2] National Bureau of Economic Research, *Recent Economic Changes,* Vol. II, p. 478.

[3] Nourse, Edwin G., and associates, *America's Capacity to Produce,* Brookings Institution, Washington, D. C., 1934.

a reapportioning of labor among the industries approximately as follows:

Industry	*Surplus Labor*	*Labor Needed*
Agriculture	500,000	
Forestry and fishing	20,000	
Mining		20,000
Manufacturing		1,000,000
Construction	135,000	
Transportation and communication	10,000	
Trade	200,000	
Service	140,000	
Totals	1,005,000	1,020,000

6. Refer to Case 55 (page 169). (a) In the light of the above discussion, appraise the viewpoint of Dr. Karl Compton. (b) What conclusion so far as economic management is concerned does the above discussion suggest?

7. Illustrate by reference to a rich nation and a poor nation that the land factor is first in importance among the various factors of production.

8. (a) What determining condition influences an industrialist in his task of proportioning the factors of production? (b) Why do we find 100-story buildings in some parts of New York City, but not in the smaller cities? (c) What general proportions of capital and labor would you expect to find in China? Why?

9. Refer to the chart, "Fundamental Relationships in Economic Life," on page xii in the front of the book. The kind of wealth, or economic goods, created depends upon what?

Utility has been defined as the power to satisfy a human want. All production is concerned with the creation of utilities. When primitive man first conceived the idea of chipping off the edges of a piece of flint in order to provide a more formidable weapon, a *form utility* was created. Today raw materials of innumerable kinds are transformed into a thousand and one articles useful in making life easier and more comfortable, and each one involves the creation of a form utility. A society today, however, dependent alone upon form utilities would be little more than primitive. Modern man transports materials vast distances, bringing them from places where they are in superabundance to places where they are relatively scarce, and he preserves and stores material for

long periods of time, making them available when most needed. Fresh vegetables are sold in New York the year round; tropical fruits and northern furs can always be had, while imported articles of various kinds are commonplace matters. *Place utilities* have been created in making these things available. *Time utilities* are represented in such goods as ice in summer, canned vegetables and meats, preserves of various kinds, and even eggs upon occasion. Railroad, steamship, and motor truck transportation companies represent industries that aim to satisfy the desire for place utilities, while storage warehouses, refrigerator plants, and ice houses are necessary to meet the demand for time utilities. Thus these three kinds of utilities—form, place, and time—indicate the kind of comforts and luxuries of life enjoyed by a community.

10. Show how, in the progress from raw material to a finished product in the hands of an ultimate consumer, all three utilities may be represented in one product.

11. As civilization has advanced, what kinds of utilities do you think have become of increasing importance? Reasons.

12. Name industries in your own community that are particularly concerned with creating each of the three utilities.

13. Are those industries engaged in transportation any less productive than those engaged in agriculture or mining? Why, or why not?

14. How may persons be engaged in productive activity and yet not be creating time, form, or place utilities?

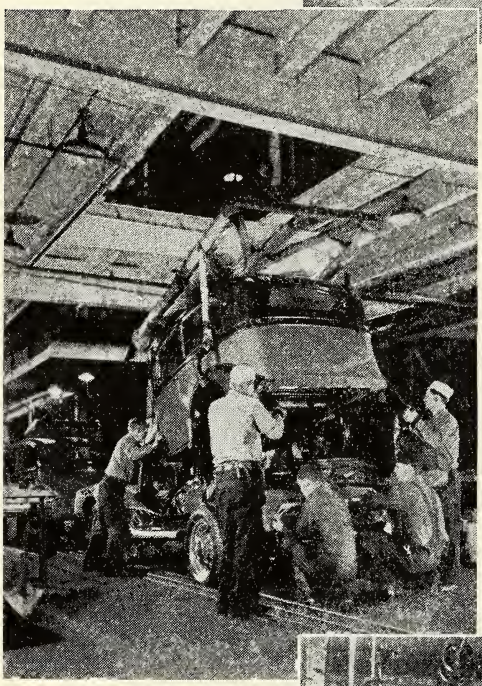
15. Submit for club discussion the question of a group visit to a factory. If such a trip is possible, appoint a committee of two to make the arrangements. The committee should call at the factory or correspond with the management in advance, explain the nature of the club, and ask permission for the proposed visit, stating a tentative date and time.

Devote a page of your notebook to the factors of production observed, noting the following: land, to what extent employed; labor, what proportion to capital, working conditions; management, idle workers or machines, too little or too much space for efficient operation; capital, kinds and how employed.

Devote another page of your notebook to the utilities observed, noting just what utilities were created and how, and also to what extent personal services entered into the operations.

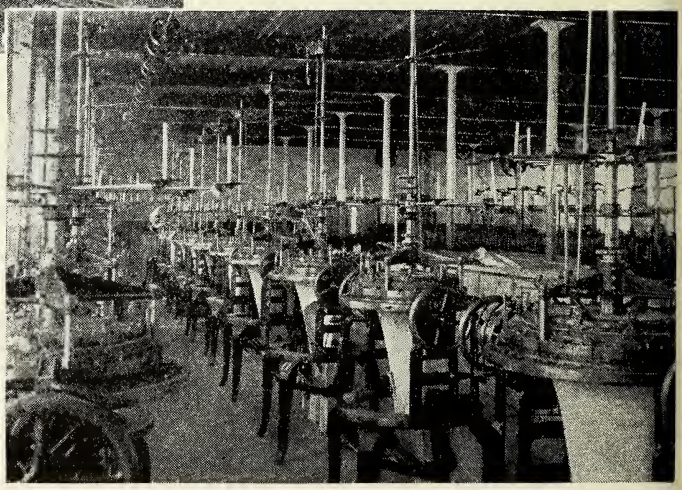
Write in your notebook a paragraph about the working conditions you observed; that is, rates of pay, hours of work, rest periods, nature of surroundings—pleasant, gloomy, clean, dirty, and so forth.

KNITTING BY HAND.



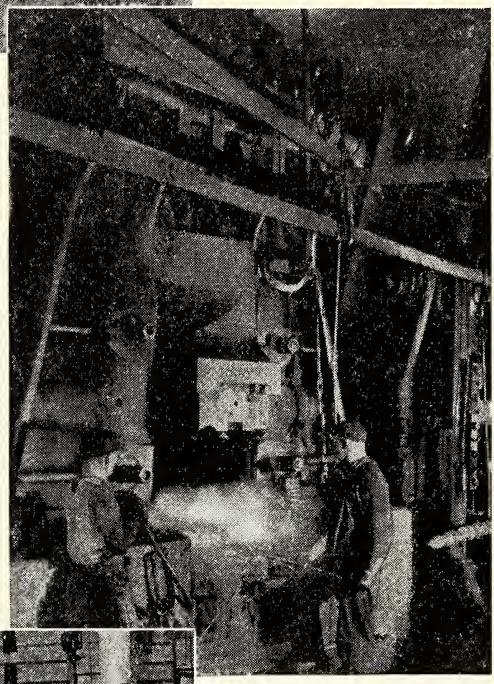
Production Methods

AN AUTOMOBILE PLANT. THE AUTOMOBILES ARE ASSEMBLED WHILE TRAVELING ALONG A CONTINUOUSLY MOVING CONVEYOR BELT.



KNITTING BY AUTOMATIC MACHINERY.

STUDENTS AND INSTRUCTOR DRESSED IN WORKING CLOTHES, READY TO OBSERVE PRODUCTION METHODS IN A COAL MINE.



A LARGE DROP FORGE FOR THE PRODUCTION OF ENGINE PARTS.

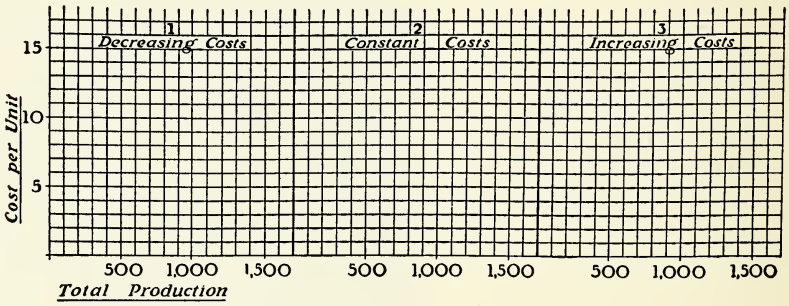
REPRODUCING PERIOD FURNITURE. VESTIGES OF THE HANDICRAFT METHOD OF PRODUCTION.

UNIT 2.—THE VARYING COSTS OF PRODUCTION

Observations and Discussions.

It is said that a large chain-store organization can buy at prices less than those the individual merchant or small buyer is offered; likewise, a hotel usually grants some reduction to its weekly or monthly guests; and there is a big difference in the cost of printed letterheads according to whether 1,000 or 100,000 are wanted. Everywhere discounts are offered for big quantity orders.

This is because in the production of articles, particularly manufactured products, more and more savings can be made as larger and larger quantities are produced. In other words, the larger the production, the less the cost per unit of the product produced.



But this does not apply to everything. In fact we shall see that whether or not it does apply in a particular case makes a big difference in many of our economic problems.

1. Prepare a chart such as the one shown in the accompanying sketch.

Costs are usually divided into *prime costs* and *overhead costs*. Prime costs include only the costs of material and labor. Overhead costs are those which cannot be applied so directly to each unit manufactured, such as heat, power, depreciation, supervision, and so forth. The costs given in the following table are prime costs.

In the first section of the chart, plot the following:

No. of Units	*Production Cost Per Unit*	*No. of Units*	*Production Cost Per Unit*
100	10	600	5
200	9	800	4
300	8	1,000	3
400	7	1,400	2
500	6		

In the second section of the chart, picture the condition when a commodity is manufactured at a cost of, say, 5, irrespective of the quantity produced.

In the third section of the chart, plot the following:

No. of Units	*Production Cost Per Unit*	*No. of Units*	*Production Cost Per Unit*
100	1	1,200	4
700	1½	1,300	5
900	2	1,400	6
1,100	3		

Perhaps the greatest monument to management and the most effective means ever devised to economize time in the production of economic goods is the plan known as the *division of labor.* This plan so allots tasks that one worker performs, at the most, only a few operations, and sometimes only one. The product is then passed to a second worker who carries it a step farther towards completion. Thus, in regular progress from floor to floor and from one end of a factory to another, the raw material is gradually converted into a finished product. The handicraft system, in contrast to the division of labor, allows a single worker to make an entire unit of product from cutting the raw material to the final finishing touches.

2. When a product can be manufactured by division of labor, the cost curve is such as shown in the first section of the chart. Why, then, is a large sales volume so essential in products manufactured by division of labor?

3. (a) How may national advertising or instalment selling actually reduce the prices of articles manufactured by division of labor, despite the added expense of these methods? (b) Can you say the same of articles manufactured under conditions of constant or advancing costs?

> **Think:** How do these methods affect the volume of sales? How are costs affected? Assuming a condition of competition, what will be the result?

4. Under such topics as "monotony of labor," "interest of employees," "quality of workmanship," "cost of product," discuss the advantages and the disadvantages of division of labor.

5. Refer to Case 56. Under what conditions of cost can art objects be produced?

6. Refer to Case 57. Discuss the merits of this plan.

Suppose that a telephone company is just starting in your community. It starts, let us say, with four subscribers—4, then, may be considered its volume of business. The company must provide the facilities in the way of power, wiring, switchboard, central office, operator, and so forth, sufficient to handle the maximum volume of traffic that may come from four subscribers. By calculating this maximum volume of traffic, we arrive at a number that may be considered an index number representing the company's cost of production. The conditions, therefore, are as follows:

The subscribers are A,B,C, and D = 4 = Volume of business

The company must provide for the following possible connections:

AB (or BA), AC (or CA), AD (or DA)	= 3	Connections
BC (or CB), BD (or DB)	= 2	"
CD (or DC)	= 1	"
Total	= 6	Connections = Cost of production

Suppose one more subscriber is added. The condition now is:

The subscribers are A,B,C,D, and E = 5 = Volume of business.

The company must provide for the following possible connections:

AB (or BA), AC (or CA), AD (or DA), AE (or EA)	= 4	Connections
BC (or CB), BD (or DB), BE (or EB)	= 3	"
CD (or DC), CE (or EC)	= 2	"
DE (or ED)	= 1	"
Total	= 10	Connections = Cost of Production

7. Calculate the condition with 6 and 7 subscribers; plot the resulting curve and show that it is a condition of increasing costs.

STORE GAINS FORESEEN IN INSTALLMENT SALES

Huge Expansion of Time-Payment Buying Is Predicted at Chicago Convention.

Special to THE NEW YORK TIMES.

CHICAGO, June 7.—Prediction of a huge expansion of installment selling by department stores was voiced today before the convention of the National Retail Dry Goods Association by Charles G. Martin, assistant treasurer of Bon Marche of Lowell, Mass.

"We have already made arrangements to meet the demand for the extension of credit on a time payment basis, a demand we feel will be greatly increased in the near future," he said

"We have evolved a budget plan of buying. The customer is given a credit card, good for from $15 to $25 worth of any merchandise selected.

"With the card the customer is given a metal plate embossed with his name ana address. For the plate which serves as identification, we charge $1.

"If the customer makes payments as agreed, we refund the dollar when payments are completed."

CASE 57

PAINTING BY HOMER IS SOLD FOR $11,000

An oil painting by the noted American artist, Winslow Homer, called "The Fisher Girl," brought $11,000 last night at the American Art Association-Anderson Galleries, Inc., in the auction of the art col-

CASE 56

PHONE COMPANY DATA GIVEN IN RATE CASE

City Attacks Method of Figuring Depreciation—Value of Plant Equipment Reported.

Detailed figures on the value of its plant equipment in this State were submitted to the Public Service Commission yeterday by the New York Telephone Company, whose rates are under investigation. The figures are part of a mass of data sought by the commission in its efforts to fix temporary rates under the new laws.

CASE 58

The New York Times.

8. Refer to Case 58. In the interests of subscribers, telephone rates are being constantly investigated by Public Service Commissions. How has it been possible for the telephone companies to keep the rates as low as they have in the face of an increasing number of subscribers?

> **Think:** What is the function of capital? How might capital be used to accomplish the purpose in question?

UNIT 3.—EMPLOYER-EMPLOYEE RELATIONSHIPS

Observations and Discussions.

1. (a) Refer to Case 59. What do you suppose Mr. Harriman means by a "suitable bargain"? (b) Is there any equality of bargaining power between the two parties concerned? Explain.

Insists Bosses Can Hire, Fire Without Strings

H. I. Harriman Tells NRA Advisers Constitution Grants That

HOT SPRINGS, Va. (AP)—Henry I. Harriman, president of the Chamber of Commerce of the United States, said today an employer has the right to deny work to a man because he is a member of a labor union if he so desires.

"The right of an employer to employ whom he will and of an employee to work for whom he will, provided a suitable bargain can be made, is a property right protected by the Fifth and Fourteenth Amendments to the Constitution," Harriman said.

CASE 59 *Newark Evening News.*

TO SEEK WAGE RISE TO MEET INFLATION

Green Says Price Climb Would Cut Labor's Buying Power and Hurt Unemployed.

REDUCTION HERE BANNED

Building Trades Heads of A. F. of L. Oppose Cut to $8 a Day on Construction Projects.

By LOUIS A. STARK

Special to THE NEW YORK TIMES.

WASHINGTON, April 21.—Organized labor's answer to inflation was a declaration today that it would move at once to fight for wage increases in order to offset the expected increase in commodity prices.

CASE 60 *The New York Times.*

Fundamentally, it is the desire for equality in bargaining power that has stimulated workers to organize unions. The first unions of any consequence in the United States were organized during the period of industrial expansion that followed the Civil War. At that time, owing to the growing size of production units, personal, face-to-face relationships between employers and employees were disappearing, while

an increasing number of men and women were becoming entirely dependent upon such money wages as they could gain through individual bargaining. As industrial units expanded into large, nation-wide combinations such as we studied in Chapter III, labor, too, began to seek consolidations of its local bodies into national associations. The Knights of Labor, created in 1869, was the first successful national labor organization. In 1886, however, disastrous strikes together with unsuccessful participation in politics led to its decline. The American Federation of Labor followed and has grown steadily ever since. This, as its name indicates, is a federation of unions, each of which retains the right to administer its own local affairs. A number of large labor organizations maintain a separate existence outside of the Federation.

Local unions are of two general types: the *trade* or *horizontal union,* and the *industrial* or *vertical union.* The first and the most common is an association of members of a given trade regardless of the kind of industry in which they may be employed; the second is an association of all the workers in a given industry regardless of their particular trades.

2. Refer to Cases 60 and 61. (a) The so-called *"yellow dog" contract* is one weapon which employers may use to gain an advantage. What is meant by a "yellow dog" contract? (b) How might "yellow dog" contracts increase the lag in real wages during a period of advancing prices?

Other weapons used by employers are: (a) The *open shop;* this is an industrial unit claiming to employ union or non-union workers without discrimination, in contrast to the *closed shop,* which employs only union workers. The open shop, however, ofttimes is in reality "open" only to non-union workers. (b) The *black list;* this is a list of the names of workers who it is believed, will, if employed, agitate in the interests of union activities. (c) The *lockout;* when employers shut their factories in order to bring the workers to terms, it is called a lockout. (d) The *injunction;* this is an order from a court forbidding labor leaders to call a strike, or, if a strike is in force, forbidding strikers to interfere with other workers who may wish to take their places. Sometimes

MINE WORKERS BACK FIVE-DAY WEEK BILL

Officer Also Calls at Hearing for Curb on Shipment of 'Yellow Dog' Goods.

WASHINGTON, Jan. 19 (AP).—Legislation to prevent the shipment in interstate commerce of goods produced under "yellow dog" contracts was proposed by the United Mine Workers of America today in endorsing the Black bill for a five-day week and six-hour day.

Philip Murray, vice president, said that with 310,000 coal miners jobless the shorter work week was "a necessity," but he urged amendment of it to outlaw the "yellow dog" contract, under which labor is employed with the understanding that it will not organize for collective bargaining.

CASE 61

The New York Times.

Company Unions Held Winners

Steel Institute Announces Final Result of Polls Conducted by Workers

NEW YORK (UP)—More than 90 per cent of steel and iron mills workers prefer company unions over outside unions, their employers said today in announcing final result of a poll conducted throughout the industry.

CASE 63

Newark Evening News.

INDUSTRIAL UNIONS URGED UPON LABOR

O'Connell and Frey, Backing Johnson View, Declare for 'Vertical' Organization.

SHIFT FROM CRAFT BODIES

Policy Put Up to Metal Trades—Building Group Report Also Calls for 30-Hour Week.

By LOUIS STARK.

Special to THE NEW YORK TIMES.

WASHINGTON, Sept. 27.—Industrial unionism based on the "vertical" organization of industry rather than craft unionism based on "horizontal" organization is the "new phase" into which the trade-union movement must move to cope with modern industrial development, according to James O'Connell and John P. Frey, respectively president and secretary-treasurer of the Metal Trades Department of the American Federation of Labor.

CASE 62

The New York Times.

injunctions have been declared which forbid the union organization from distributing benefits to strikers. (e) The *trade association;* this is an organization of employers. Through such associations employers are enabled to put up a united front against the demands of labor.

3. Refer to Cases 62 and 63. Employers often object to dealing with labor leaders representing outside unions, that is, unions of the trade type. Employers claim that such leaders are only remotely associated with the employees seeking negotiations with the management and are, therefore, not in a position to discuss a given situation in any particular factory intelligently. Employers have, therefore, organized *company unions,* that is, organizations of their own employees sponsored by the company. (a) How are labor leaders meeting this move? (b) Discuss the comparative merits of outside and company unions.

Other methods used by workers to enforce their demands are: (a) The *strike;* this, perhaps, is labor's most powerful weapon. (b) *Picketing;* this is a means of inducing those who would continue to work to join the strikers. (c) *Boycott;* by means of a boycott, employees attempt to bring the companies to terms by inducing the public to stop buying the goods of the particular companies that are involved in the dispute.

4. Arbitration agreements have been worked out in some industries by means of which disinterested individuals intervene in the case of a dispute between the employers and employees and adjust the differences. Labor Boards which attempt to arbitrate labor disputes have been organized by governmental units, but such Labor Boards are without the power to enforce their decisions. Would you advocate giving Labor Boards the authority to enforce their decisions in order to eliminate strikes?

5. Submit for club discussion the possibility of visiting some nearby union headquarters. If such a visit is possible, appoint a committee of two to investigate the matter and to make the necessary arrangements. In some cities there is a labor temple, which houses the offices of various unions and provides assembly and recreation rooms for workers. If there is such a labor temple in your community, this is the place to go. Arrangements should be made in advance with the secretary of some union to address the group and to answer questions.

Write in your notebook an account of the visit, the main viewpoints expressed by the speaker, and your own reactions concerning these viewpoints.

Conclusions.

A. In this chapter you have learned something about the creation of wealth.

1. What are the factors of production?
   (a) What conditions determine the proportions in which the factors of production will be combined?
      (1) What changes in these proportions have taken place in recent years?
      (2) How has unemployment been affected by these changes?
   (b) In what respect is land the basic factor of production?
2. Production aims to create what kinds of utilities?
   (a) How have the kinds of utilities created changed as civilization has advanced?
   (b) In what different ways may productive activity take place in modern economic society?

B. What are the three types of cost curves that characterize production?

1. What is division of labor?
   (a) When an article is produced by division of labor, what is the usual type of its cost curve?
      (1) What conclusions can be drawn in reference to instalment selling and national advertising?
2. Give examples of articles produced under conditions of constant and increasing costs.

C. What fundamental question is at the bottom of employer-employee disputes?

1. Trace the development of unionism in the United States.
   (a) What types of unions exist today?
   (b) Describe the organization of the American Federation of Labor.
      (1) Does this organization comprehend all organized labor in the United States?
2. What weapons do employers use against labor?
   (a) Explain the following: open shop, trade associations, black list, lockout, injunction.
3. What weapons does labor use?
   (a) Explain the following: picketing, boycott, strike, closed shop.
4. What methods have been used to do away with industrial strife?

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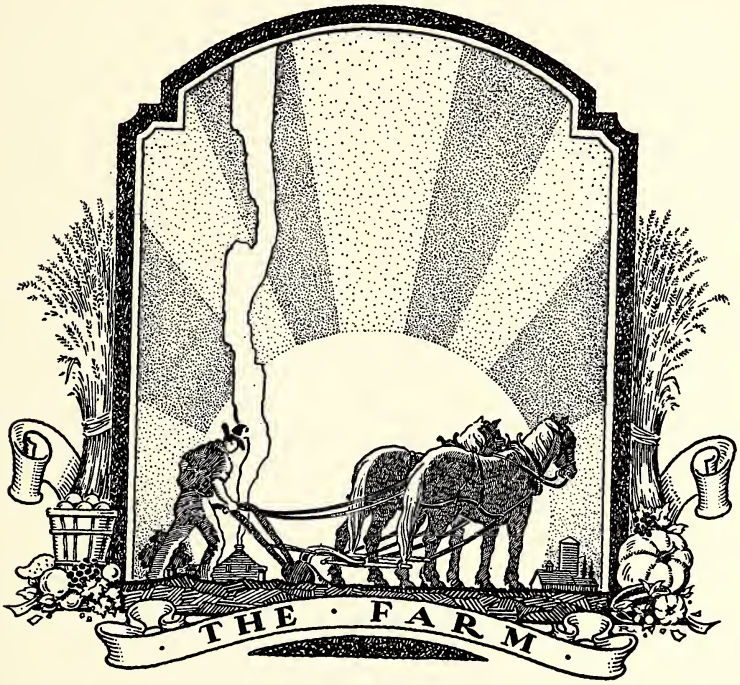
CHAPTER XI



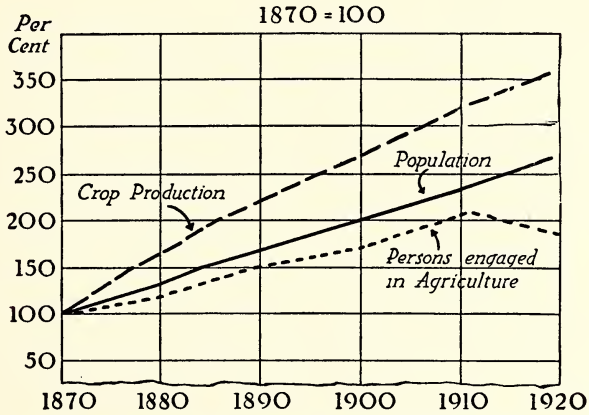
CHAPTER XI

The Farm

UNIT 1.—FARM PRODUCTION

Observations and Discussions.

1. Refer to Case 64 (page 192) and to the following chart.[1] What change in the factors of production—particularly after 1910—is indicated?



Growth of Agriculture, U.S. 1870-1920

2. Refer to the chart on page 170. What is indicated in the way of a demand for manufacturing labor—particularly after 1914?

3. Refer to the chart on page 190.[2] (a) Aside from a mere increase in numbers, what population change is shown? (b) In the light of your answers to questions 1 and 2, explain this change.

4. Associate the following events, showing how each one led to the next one mentioned: (a) shift in the factors of production in agriculture, (b) growth in manufacturing, (c) population migration to cities, (d) shift in the factors of production in manufacturing, (e) unemployment.

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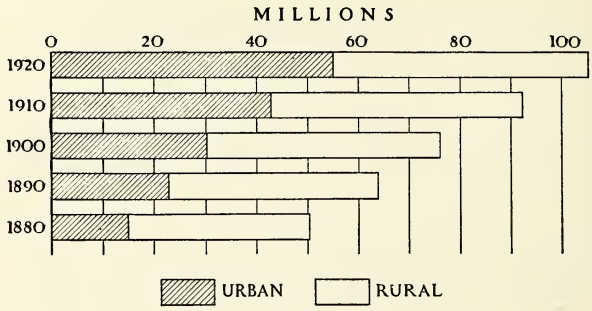
[1] National Industrial Conference Board.

[2] Statistical Atlas of the United States, 1924.

Unlike the manufacturer, the farmer cannot always balance the factors of production to the best advantage. Even assuming that labor and capital are as readily available to the farmer as to the manufacturer, land is not. Particularly is this so in older countries where population has increased rap-

1. URBAN *and* RURAL POPULATION: 1880-1920



idly and the total area is not large. When any factor of production, such as land, cannot be increased, and production is augmented by increasing the other factors, a condition results known as diminishing returns. The *law of diminishing returns* may be stated as follows: when any factor of production remains constant and equal successive doses of another factor are added, the total product is increased with each successive dose, but eventually a point is reached when the amount of the increase grows smaller with each successive dose. For example:

5. On a farm of a given number of acres, equipped with a certain amount of capital, a farmer constantly adds labor. He finds that the following conditions prevail:

Labor (Number of Men)	*Total Production (Bushels)*	*Labor (Number of Men)*	*Total Production (Bushels)*
1	25	6	180
2	52	7	203
3	81	8	224
4	112	9	243
5	145	10	260

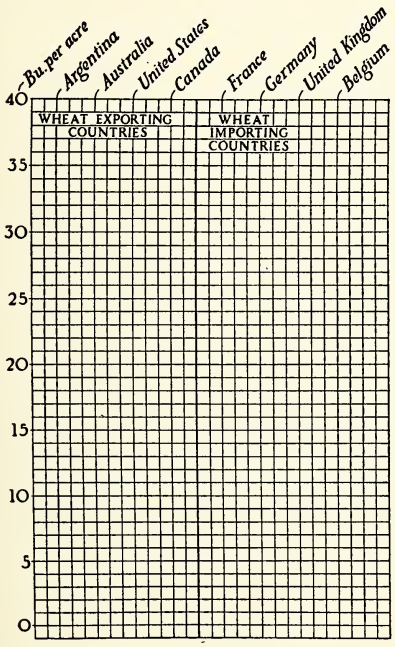
(a) Has there been an increase in the total production with every additional dose of labor? (b) At what point did an additional dose of labor

yield a lesser return than was yielded by the dose of labor added just previously? (c) Where, according to this production schedule, is the point of diminishing returns?

6. Suppose that the labor cost is $12.00 per man and that the market price for the product is 50c a bushel. Other costs, being constant, may be ignored. (a) What is the most profitable quantity for the farmer to produce? (b) Should he push production beyond the point of diminishing returns?

7. With the same costs, suppose that the market price is $1.00 per bushel. (a) What is the most profitable quantity for the farmer to produce? (b) Should he push production beyond the point of diminishing returns?

8. (a) Will a farmer necessarily cease production at the point of diminishing returns? (b) What will determine whether he does or does not?



When a farmer increases production by the addition of land, he is said to be carrying on *extensive* cultivation; when he increases production by the addition only of capital and labor, he is said to be carrying on *intensive* cultivation. Intensive cultivation, then, is the usual channel by which the condition of diminishing returns is reached.

9. Does the fact that a farmer may work the same amount of ground more intensively year after year show that the law of diminishing returns is inoperative? Why, or why not?

10. Suppose that a new variety of wheat were produced having more kernels to the stalk, thus making possible a larger bushel yield per acre; would this invalidate the law of diminishing returns? Why, or why not?

11. Prepare a chart such as the one shown in the accompanying diagram, and plot bars showing the average per acre yield of wheat in the various countries in accordance with the following statistics:

WHEAT EXPORTING COUNTRIES

Country	*Bu. of Wheat Per Acre*
Argentina	11.9
Australia	13.4
United States	14.9
Canada	17.8

WHEAT IMPORTING COUNTRIES

Country	*Bu. of Wheat Per Acre*
France	20.8
Germany	26.8
United Kingdom	32.7
Belgium	38.7

12. Refer to the above chart reproduced in your notes. What relationship may be noted in the matter of imports and exports of wheat and the average yield per acre in the various countries?

FARM HORSES LOSE AGAIN.

Tractor's Furrows Best in Mid-West Plowing Contest.

WHEATLAND, Ill., Sept. 17 (AP). —Once more Homer Lapp, the only contestant to compete with "Oats Power," was defeated in the Wheatland plowing contest, the mid-West farm classic.

Carl Shoger, who piloted a two-button tractor, equipped with pneumatic tires fit for a limousine, won the championship for the third time in as many years. The judges graded him at 82 and Lapp at 71; 100 being perfection.

Lapp might have won last year had not the airplanes caused his three big horses to rear and make the furrows crooked. The same thing happened today, but the judges agreed that Lapp could not have won even if his horses were not diverted.

CASE 64

WILL AID CANADA'S WHEAT.

Treaty With France Halves the Tariff of $1.70 a Bushel.

WINNIPEG, May 12 (Canadian Press).—Encouraged by the signing of the new Franco-Canadian trade treaty, expected to afford a freer movement of Canada's wheat, traders today supported futures on the Winnipeg grain market.

The new treaty indicates increased wheat exports to France, as Canada's wheat now will enter that country at a duty of 85 cents a bushel. The old rate, in force since last June and which had virtually excluded wheat imports, was $1.70 a bushel.

CASE 65

The New York Times.

13. (a) What inference might you draw, therefore, as to the operation of the law of diminishing returns in wheat production in the wheat-importing countries? (b) Describe the conditions that you would expect to find on a wheat farm in England.

14. Refer to Case 65. Why is it of advantage to France to arrange for the importation of Canadian wheat?

> **Think:** Is wheat produced in France at a greater or less expense of capital and labor than in Canada? To the extent that labor and capital are devoted to the production of wheat, they cannot be devoted to the production of other wealth. How, then, is the total amount of wealth produced in France affected by importing Canadian wheat?

15. How does the operation of the law of diminishing returns affect international interdependence?

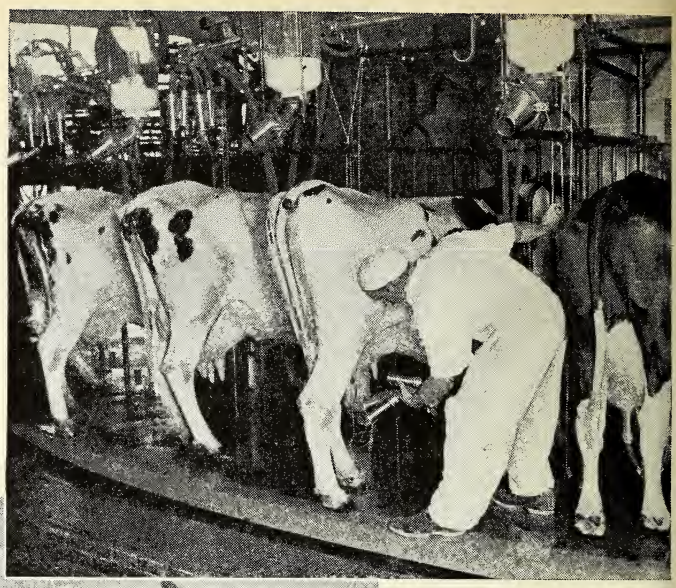
In 1798 Thomas Robert Malthus published in England the first edition of his celebrated work, "An Essay on the Principle of Population." In this book he set forth the thesis that population tends to increase faster than food supply, and that therefore the human race could look forward only to ultimate starvation and distress.

Mathus was influenced by economic conditions in England. The Industrial Revolution was in progress, and, in consequence, there was a vast amount of unemployment, poverty, and distress throughout the land.

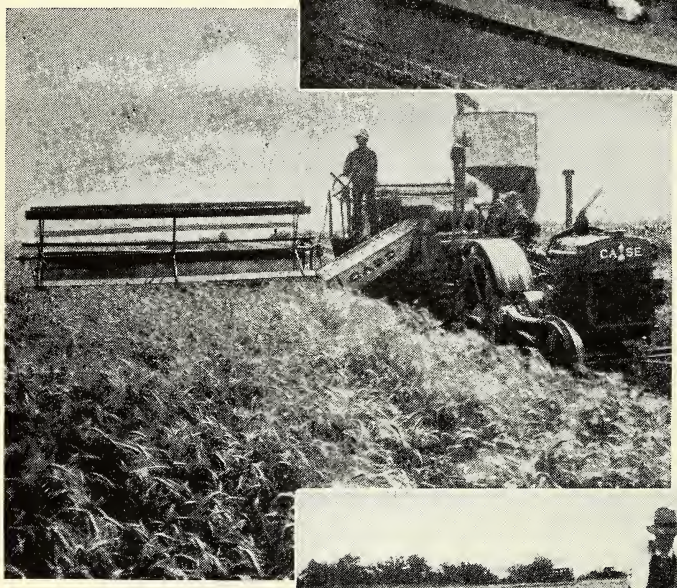
In 1800 there were 600,000,000 or 700,000,000 people in the world; today the number is perhaps 1,948,000,000. Nevertheless, it has been stated that in Canada there are 300,000,000 acres fit for growing wheat—including the recently discovered frost-resistant variety—and only 23,000,000 acres at present are under cultivation; and in Australia, likewise, only a small portion of the available area has yet been brought under cultivation. Argentina is another country with great possibilities in wheat production.

Henry C. Carey (1793–1879), an American writer, denied the theory of population set forth by Malthus, and claimed that food increases faster than human beings. Influenced by the extensive unoccupied areas in America, Carey could not conceive of a time when the land factor might be limited.

16. (a) Which viewpoint do you think is nearer the truth, that of Malthus or that of Carey? (b) What did Malthus fail to take into account? What did Carey fail to consider?



MODERN DAIRY FARMING. THIS "ROTOLACTOR" CONSISTS OF A ROTATING PLATFORM THAT AUTOMATICALLY WASHES, DRIES, AND MILKS FIFTY COWS EVERY TWELVE AND A HALF MINUTES.

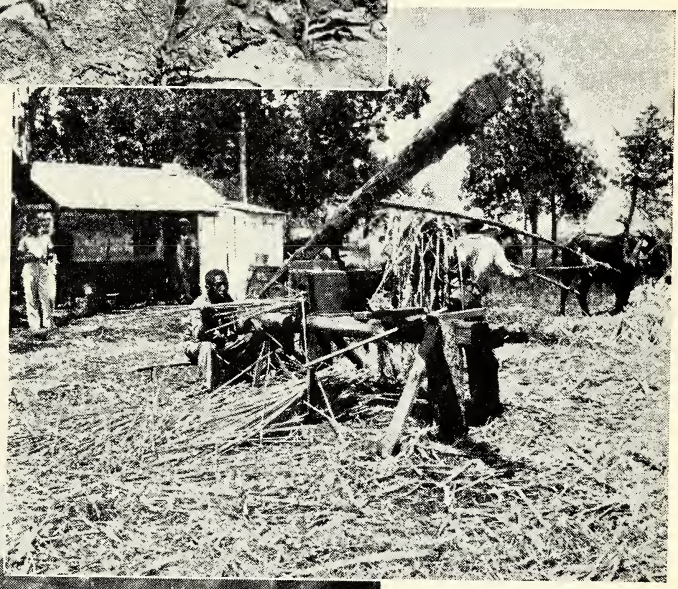


The Farm

MASS PRODUCTION FARMING. HARVESTING AND THRESHING WHEAT IN ONE OPERATION.

MODERN FARM METHODS. TERRACING TO PREVENT WASHING AWAY OF THE TOP SOIL.

PRIMITIVE FARMING.



PRIMITIVE METHOD OF GRINDING SUGAR CANE.

INTENSIVE FARMING. A SPRINKLER SYSTEM THAT WATERS THE CROPS IN DRY WEATHER.

Think: Keeping in mind the unfailing ultimate working of the law of diminishing returns, do you think Malthus was right in principle?

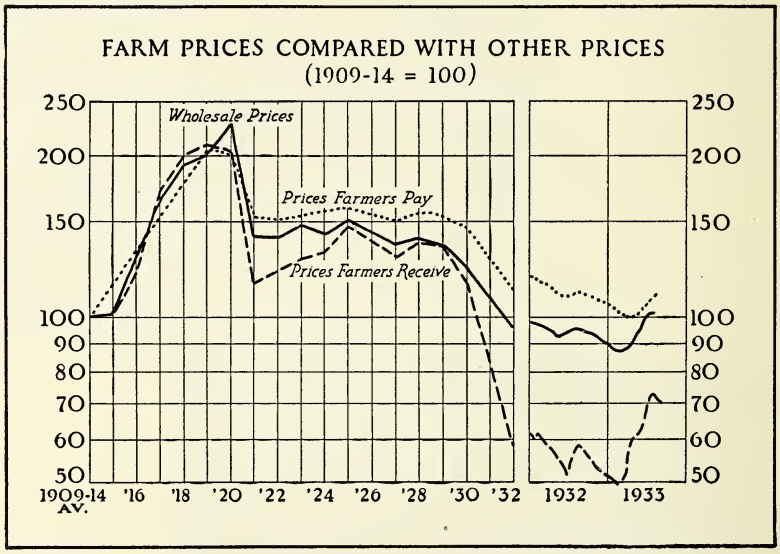
Carey did not admit the validity of the law of diminishing returns. What of his viewpoint?

UNIT 2.—THE FARMERS' PROBLEMS

Observations and Discussions.

1. Depending upon circumstances, individual observations may be made of various nearby farms, or a group visit may be made to one particular farm. If a group visit is decided upon, make the preliminary arrangements in the usual way.

Devote a page of your notebook to the factors of production observed on the farm. Note the following: land, how much under cultivation; capital, its nature and to what extent used—fertilizer, machinery, sprinkler system, etc.; labor, quantity employed. Decide whether the farm is

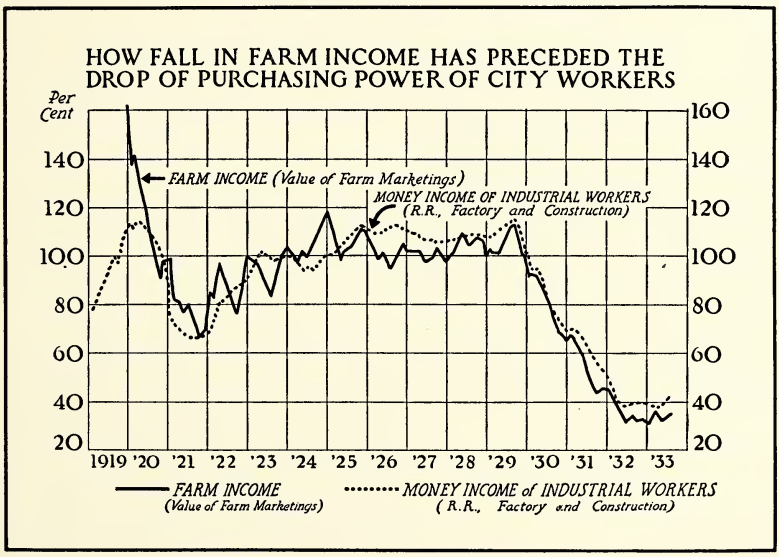


Moody's Investors Service.

cultivated extensively or intensively. Find out, if possible, how the prices of things the farmer buys compare with the prices he receives for the products that he sells. Find out, if possible, the "spread" between what the farmer receives and what the consumer pays in the case of two or three specific products.

Whatever ultimate troubles may be in store for the American farmer, his immediate problem is one of producing less rather than more. During the World War, agricultural production in Europe was drastically reduced. This condition stimulated the raising of more food products in the countries not so vitally affected by the war. During the years that followed, European countries gradually recovered their former places as producers, while no comparable reduction took place elsewhere. This brought about a condition of oversupply in agricultural products.

2. Refer to Case 66 (page 198) and to the chart on page 196. (a) How did the prices of farm products compare with the prices of other products during the period from 1914 to 1920? (b) What change took place about 1920? (c) Compare the two sets of prices during the period from 1920 to 1932. (d) When conditions are such as shown during this last period, how is the purchasing power of the farmer affected?



United States News.

3. Refer to Case 67 (page 198). Show that it is to the individual farmer's interest to plant as much acreage as possible so as to be able to pay his debts and provide an income for his needs, but that it is to the collective interest of all farmers to cut down acreage.

4. Refer to the above chart. (a) What relation exists between a fall in farm income and a drop in the purchasing power of

FARMER'S DOLLAR DROPPED IN MONTH

Prices of His Products Lower on Aug. 15, While Goods He Bought Were Higher.

RATIO BELOW PRE-WAR

Federal Bureau Reports Milk Is Bringing Dairymen Less, Although Buyer Pays More.

WASHINGTON, Aug. 28 (AP).—After mounting steadily month by month since March, farm purchasing power received a sharp setback between July 15 and Aug. 15, the opening of harvest seasons for many crops.

The Bureau of Agricultural Economics reported today that purchasing power of farmers as of Aug. 15 was 64 per cent of the average for the pre-war period, 1909 to 1914. In June it was 62 per cent, then moved up to 71 per cent of pre-war on July 15.

Prices of farm products fell, while the cost of the materials the farmers most commonly buy went up, the latter reaching a point on Aug. 15 where they averaged 12 per cent. over pre-war prices.

Using the figure 100 to represent pre-war prices

CASE 66

TUGWELL PREDICTS BIG CUT IN FARMING

Says 50,000,000 Acres May Be Withdrawn Unless Demand for Products Increases.

Special to THE NEW YORK TIMES.

PHILADELPHIA, Dec. 29.—The United States may have to withdraw 50,000,000 acres, or one-seventh of all its cultivated lands from production unless the demand for farm products can be increased, Professor Rexford G. Tugwell, Assistant Secretary of Agriculture and a member of the "brain trust," told the American Farm Economic Association today.

He added that the estimate of 50,000,000 acres to be taken out of production might have to be increased unless gains in exports and improved standards of living overbalanced increased agricultural efficiency and other factors which make for overproduction as compared with consumption.

Under a permanent plan of controlled agriculture as he saw it, the most efficient farmers would use the best lands which remained in cultivation, operating at maximum efficiency "without flooding markets."

Before there could be determination of exactly how much land should be used for agriculture in a permanent program, the government would have to decide whether future development of the country would be toward a nationalistic or international economy; what the future growth of population would be; how nearly the food needs of the population would be met by increased agricultural efficiency, and whether people would continue to live at subsistence standards or advance in purchasing power through efforts to devise a new economic organization.

CASE 67

The New York Times.

city workers? (b) Show that the farm problem is really a national problem.

Farm products are sometimes marketed direct to consumers. Immediately beyond the residential areas of most towns and cities are small farms producing a variety of foodstuffs. These producers frequently deliver their products to ultimate consumers, or the individual purchasers may go to the farm and carry away the products by automobile. Then, too, hops, wool, rice, and apples are frequently purchased right on the farm by merchants who carry on extensive operations and who may be classified as consumers because they use these commodities as raw materials in the manufacture of other products.

Far more important in the scheme of marketing farm products, however, is the plan by which one or more *middlemen* enter into the process. The town or rural community merchant who receives eggs, farm-made butter, poultry, etc., from farmers and sells to consumers is a middleman. He adds a place utility to such products and makes a profit from his sales.

This simple process may be complicated by more intermediaries. Watermelons from the region of San Antonio, Texas, are said to be distributed through three middlemen: first, the local buyer or shipper; second, the commission dealer or wholesale merchant; third, the retail merchant. East of the Mississippi River, fruit is sometimes sold first to a country buyer, then shipped to a city commission dealer, who turns it over to an auctioneer. The auctioneer disposes of the fruit to a jobber, who in turn sells it to a retail merchant. Thus five middlemen are involved.

Unfortunately for the farmer, he is usually in a position of having to ship his products at a specific time. He must rely, then, upon some commission merchant, let us say, to get the highest possible price for the products. Under conditions of oversupply, which we have already noted, the highest possible price is ofttimes little more than enough to meet the transportation and selling expenses. The farmer gets what is left after all other such expenses have been met, and this is too often little or nothing. This is why we so often read of wheat

being burned, melons dumped into the river, and lemons given away on the farm for the asking.

5. Calculate the return to the farmer in the following instances, and the percentage of "mark-up," that is, the per cent that, when added to the farmer's price, equals the amount paid by the ultimate consumer: (a) No. 1 Baldwin apples produced in Marlboro, Mass., and consumed in Boston. Picking, 25c; barrel, 25c; freight, 25c; commission, 25c; sorting, 15c; labeling and carting, 10c; storage, 50c; wholesaler, $2.00; retailer, $1.50; price paid by ultimate consumer, $7.50 bbl. (b) Milk produced in Worcester County, Mass., and sold in Boston and vicinity. Transportation, ½c; contractor, 2¾c; peddler, 2c; price paid by ultimate consumer, 8c. (c) California potatoes consumed in San Francisco. Freight, 10c; commission merchant, 26c; wholesale and retail dealer, 44c; price paid by ultimate consumer, $1.50 (sack).

Conclusions.

A. What problem does the farmer face in adjusting the factors of production he employs?

1. Show a sequence of events between changes in the factors of production on the farm and in industry, and unemployment.
2. Explain the difference between intensive and extensive agriculture.
3. What is the law of diminishing returns?
   (a) What is its relation to market price?
   (b) What is its relation to improved techniques?
   (c) How does it bring about interdependence among nations?
4. What ideas regarding population growth were set forth by Malthus and by Carey?
   (a) Name a vital point overlooked by each.

B. What basic condition is at the bottom of the farm problem?

1. How is this condition reflected in prices?
   (a) How are economic conditions in general affected by this price condition?
2. In what respect is coöperation needed to adjust the difficulty?
3. How do distribution costs intensify the problem?
   (a) Describe some methods in marketing farm products.

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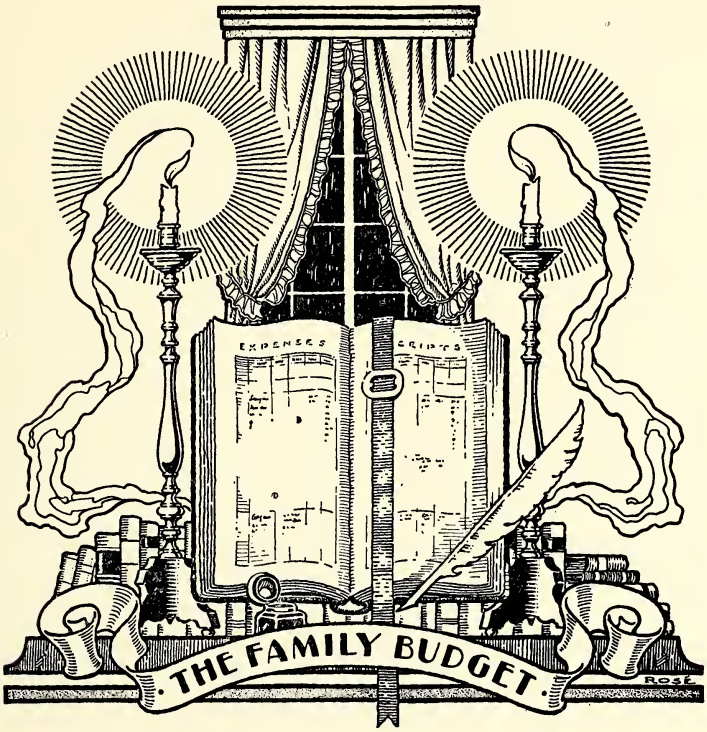
CHAPTER XII



CHAPTER XII

The Family Budget

UNIT 1.—HOW A BUDGET IS PREPARED

Observations and Discussions.

A *budget* is simply a systematic means of apportioning future income so as to gain the maximum amount of satisfaction from it. So many enticing things are constantly being pressed upon us that in the absence of cool premeditation, when all wants can be carefully weighed against estimated income, we are likely to allow some passing fancy to overshadow all else until it is too late and we are committed on the dotted line.

The task of compiling a budget for the first time is not an easy one. Questions naturally arise which are hard to answer without some guidance. What should I spend for rent? What is a reasonable amount to set aside for clothing? How much can I afford for recreation and entertainment? What should I give to charity? Such inquiries can be answered, in part at least, by an examination of how families actually do spend their incomes.

About the middle of the last century Ernst Engel, head of the Prussian Statistical Bureau, conducted investigations with a view towards discovering the relative importance of the leading items in family budgets.

As a result of this investigation, Engel set forth certain deductions which have come to be known as *Engel's Laws.* These so-called laws, stated below, are, in fact, merely generalizations about how families in Saxony did actually spend their incomes at the time mentioned:

(a) The greater the income, the smaller relative percentage of outlay for subsistence.

(b) The percentage of outlay for clothing is approximately the same, whatever the income.

(c) The percentage of outlay for lodging or rent, and for fuel and light is invariably the same, whatever the income.

(d) As the income increases in amount, the percentage of outlay for sundries becomes greater.

Engel's studies were confined to low-income groups. More recent studies, including studies of family incomes in the higher-income brackets, point to some necessary modifications in generalizations (b) and (c) above. The per cent spent for clothing, it would seem, increases for a time as income increases; then decreases. The per cent spent for shelter in-

CASE 68

United States News.

Costs More Today To Fill Larders; Food Price Jumps

Labor Department Survey Shows Expense of Food At Retail on the Up-grade; Meats Rise

MANY a family budget, perfectly good and serviceable last year, has been revised.

And all because the corner grocer

CASE 69

The New York Times.

PUPILS FIX HOME BUDGETS.

Economical Menus for Families Devised in 400 City Schools.

During the current week pupils in home-making classes in 400 public school buildings are showing parents how to run their households on reduced budgets by purchasing and preparing food that will maintain health and at the same time lower costs. The "economy week program" is under the direction of Miss Martha Westfall, director of home making.

Mimeographed receipts and menus

creases until the higher incomes are reached, while that for fuel and light decreases.

From such studies, tables have been prepared which set forth what may be considered a reasonable distribution of family incomes of various amounts. One such table is reproduced below. As a general guide in compiling a family budget, this will be found useful, in that it answers many of the questions that beset the budgetmaker.

1. Budget books may be obtained at most stationery stores. A very good one may be obtained for ten cents by writing to the National Thrift

SUGGESTED BUDGET ESTIMATES *

INCOME FOR ONE MONTH, INCLUDING RECEIPTS FROM ALL SOURCES	$100	$150	$150	$200	$200	$250	$300	$400
NUMBER OF PERSONS IN FAMILY	1	1	2	3	4	4	4	4
SAVING — Savings bank, building and loan association, payment on home, life insurance, governmental securities, reliable stocks and bonds, etc	10	25	10	15	10	20	30	50
GIVING — Church. Sunday School, missionary enterprises, hospitals, settlements, etc.	5	10	5	10	5	10	15	25
FOOD — Groceries, meat, dairy products, bakery, fruit, vegetables, eggs, cost of meals, etc	35	40	45	50	60	60	65	75
SHELTER — Rent or interest on mortgage (if home is owned and mortgaged), upkeep and repairs, plumber, carpenter, mason, decorator, painter, supplies, property taxes, fire insurance, care of lawn, etc	20	33	40	50	55	60	70	85
CLOTHES — Outwear, underwear, hats, shoes, stockings, ties, collars, gloves, mending, dressmaker, tailor, etc	10	12	20	30	32	35	35	40
OPERATING EXPENSE — Fuel, light, water, ice, telephone, extra help, children's allowance, barber, hairdresser, laundry, carfare, insurance on furniture, burglary insurance, automobile expense, health and accident insurance, taxes, rugs, new furniture, kitchen equipment, silverware, pictures tools, typewriter, repair on furniture, personal gifts, postage, stationery, etc	10	15	20	30	33	45	55	75
ADVANCEMENT — Recreation, vacation, medical attention, dentist, optician, periodicals, lectures, books, sports, theater, lodge or club dues, music, phonograph records, radio, travel, education, movies, entertainment, etc	10	15	10	15	5	20	30	50
TOTAL INCOME	$100	$150	$150	$200	$200	$250	$300	$400

* *Income Management Budget Book*, National Thrift Committee of the Young Men's Christian Association, 347 Madison Ave., New York.

Committee of the Young Men's Christian Association, 347 Madison Ave., New York City, and asking for the "Income Management Budget Book." Appoint a committee to look into the matter and to recommend a budget book to the club. Members desiring to order one may then do so through the committee. If several different kinds of budget books can be obtained, a very interesting display can be arranged by the committee.

2. Refer to your budget book; or, if you did not buy one, to the suggested budget estimates shown above, and compile a family budget.

3. Explain why it is impossible to derive the maximum satisfaction from a limited money income without the use of a budget.

4. Refer to Case 68 (page 206). Why is a budget particularly necessary during a period of advancing prices?

5. Refer to Case 69 (page 206). Show why the intelligent purchase of food is particularly necessary for families with small incomes.

6. If you have a budget book, study it carefully. Explain the method used for constantly checking actual expenses against budget estimates. If you did not purchase a budget book, devise a method for doing this.

UNIT 2.—COÖPERATIVE PURCHASING

Observations and Discussions.

Partially in order to control quality, and partially in order to reduce prices through savings in distribution costs, there have been organized in many parts of the world *Consumers' Coöperative Societies.* Such organizations provide a means whereby people may unite and use their own resources to supply their own needs.

Each member advances a certain amount of money or property to form the working capital of the group business. Interest is paid for this capital at a fixed rate and at the minimum rate current in the community. Each member has one vote and only one vote in the administration of the affairs of the society. The members have direct control of the business through a Board of Directors which they elect. This board appoints experts to carry on the business for the members.

Coöperative societies usually start by simple retailing. Commodities are bought direct from sources of supply and are sold to the members for cash. In the interests of ex-

pediency, it is customary to supply the members at current market prices. What is ordinarily profit in capitalistic business accumulates as saving in the coöperative treasury and belongs to the members.

After the payment of all expenses and the setting aside of such funds as may be voted for other uses, the balance is returned to the members in proportion to their patronage.

Coöperative Cafeteria in One of our Large Cities.

Thus, if a society's total volume of sales for a year amounts to, say, $100,000, and a certain member's total purchases amount to $100.00, then that member is entitled to one tenth of one per cent of whatever fund is to be distributed.

From simple retailing, coöperative societies move to wholesaling. The wholesale businesses are owned by the retailing societies, in whose interests they are solely conducted. They are administered and controlled by the same methods as are their constituent societies. Wholesaling moves on to importing, warehousing, and manufacturing. Manufacturing moves towards the control of raw materials, plantations, fields, mines, and forests. For the purpose of conference, mutual service, protection, and international commerce, societies fed-

erate nationally, and national federations unite internationally in the International Coöperative Alliance.

The workers employed by coöperative societies are encouraged to form their own unions. They are also encouraged to

NEW COMPETITION FACED BY INDUSTRY

G. A. Renard Says Cooperative Purchasing by Consumers Is Growing Steadily.

Manufacturers and distributers who have used their codes to impose rigid mark-up provisions and to outline the distributive channels through which goods must move to consumers are encouraging the growth of a new form of major competition, the consumer cooperative movement, George A. Renard, secretary-treasurer of the National Association of Purchasing Agents, warned here yesterday. Cooperatives, which are exempted from many of the regulations imposed upon other distributers by the codes, he pointed out, are represented on practically all the consumer councils set up in forty-six States by Dr. Paul H. Douglas, who retires from the Consumer Advisory Board of NRA today after launching the council work.

"The recent rapid growth of cooperatives in the marketing of gasoline is causing serious concern in the oil industry," Mr. Renard continued. "Under the oil code a minimum mark-up of 6 cents a gallon is mandatory in the movement of gasoline through the jobber and retailer to the consumer."

Swedish Consumers Organized.

In Sweden, where a planned economy has been in operation for some time, Mr. Renard said, 40 to 60 per cent of all consumer goods are purchased through cooperatives and 25 per cent of the production of such goods is under the management of cooperatives.

Even manufacturers of supplies for industry, he added, are threatening their own markets through control of prices and restrictive marketing conditions. Automobile plants, objecting to higher costs of steel, are preparing to produce their own supplies, he said, factories using fibre containers in quantity have arranged to supply their own needs and some steel barrel users are following a similar course.

"The same trend is noticeable in scores of other industrial lines," he concluded, "and unless some action is taken by manufacturers to modify their own codes they will face a new form of competition in consumer and capital goods as well."

Manufacturers questioned during the week insisted that the codes themselves were not at fault and laid the blame upon the government, which, they held, had lent aid and comfort to those who desired to form consumer cooperatives.

CASE 70

The New York Times.

become members of the society for which they work. Labor is thus given a voice in determining wages and working conditions.

In many sections of the world, the majority of business is carried on by coöperative societies. In some cities and in

some countries, more than half of the population is thus served.[1]

1. Appoint a committee of one to write to the Coöperative League of the United States, 167 West 12th Street, New York City. Explain the nature of the club, and request information in the form of pamphlets that can be distributed among the members of the club.

2. How does a coöperative society differ from a stock corporation in the matter of distribution of profits?

3. Do you think that a coöperative form of industry would solve the difficulties that arise over the clash of interests between capital and labor? Why, or why not?

4. Refer to Case 70. What does this article suggest as to the difficulties coöperative societies have in getting started in the United States?

UNIT 3.—DIFFICULTIES OF WISE BUDGETING

Observations and Discussions.

1. Consult old magazines and newspapers from which clippings can be made. Select advertisements on the following topics, clip them, and paste them in your notebook:

Fat reducers.
Moth-controlling agents.
Automobile lubricating oil.
Washing compounds.
Varnish.
Breakfast foods.
Disinfecting sprays.
Deodorants.
Cleaning fluids.

2. Opposite each clipping in your notebook place an appropriate quotation selected from the following:

"It can be laid down as a broad principle that all 'obesity cures' come under two classes; those that contain thyroid extract and will actually reduce weight but are exceedingly dangerous, and those that do not contain thyroid and will not under any circumstances reduce weight."[2]

"Moth-controlling agents, costing ridiculously small sums to make, are marketed at gross profits on the cost of ingredients ranging from 2,000 to 200,000 per cent. A whole family of these nostrums revolve around the principle of filling a closet or bu-

[1] Adapted from a pamphlet, "What is Consumer Cooperation?", by James Peter Warbasee.

[2] Chase, Stuart and Schlink, F. J., *Your Money's Worth,* A Study in the Waste of the Consumer's Dollar, p. 128, quoting from Dr. Arthur J. Cramp, director of the Bureau of Investigation of the American Medical Association.

reau drawer with an exhalation presumably obnoxious to moths. None of them are effective under the conditions for which they are recommended." [3]

"Engineers testing oils reported to the Society of Automobile Engineers that 'the oil which gave the most carbon in all tests was that which sold at the highest price.' " [4]

"A washing powder formerly sold to the Government at 16 cents a pound, and used for scrubbing floors was identified as ordinary washing soda, available at 2 cents a pound." [5]

"The University Buyers Association tested the durability of floor varnish. It found that varnish at $1.70 per gallon was equal in wearing value to varnish at $6.00." [6]

". . . prepared breakfast foods retail as high as 68 cents a pound by the package. . . . The housekeeper by grinding her own wheat in an ordinary coffee mill can secure a good cereal breakfast food for 3 or 4 cents a pound." [7]

"Disinfecting spray made of formalin, perfume, and Lake Michigan water, was marketed under a brand name at the rate of $62 a barrel." [8]

". . . most deodorants are paraffin oil (20 cents per gallon), with 2 per cent of pine oil added, making a total cost of say 22 cents a gallon. The manager will pay in the neighborhood of $2.50 per gallon." [9]

". . . carbon tetrachloride, an effective grease solvent, a clothes-cleaning and moth-killing agent, and a fire-extinguishing liquid. It is widely sold under many proprietary names at prices ranging from 50 cents to 90 cents a pound. It may be bought at wholesale in moderate quantities for 8 cents per pound." [10]

3. Refer to Case 71. In the light of the material collected in your notebook, do you think that the criticisms are justified? Discuss, with illustrations.

4. Refer to Case 72. Do you think that governmental regulation to the extent suggested is justified?

5. Appoint two committees of one each to correspond with certain agencies that are endeavoring to help consumers in wise budgeting.

Two such agencies are: Consumers Research, Inc., Washington, New Jersey, and Consumers Union of United States, Inc., 22 East 17th Street, New York City. These are non-profit membership corporations organ-

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[3] *Ibid.*, p. 158.
[4] *Ibid.*, p. 87.
[5] *Ibid.*, p. 90.
[6] *Ibid.*, p. 90.
[7] *Ibid.*, p. 88.
[8] *Ibid.*, p. 88.
[9] *Ibid.*, p. 89.
[10] *Ibid.*, p. 89.

Consumers' Need Of Straight Facts In Advertisements

CHANGE advertising from the psychological to the informative appeal. Give women fewer adjectives and more facts about an advertised product.

This in effect is what Alice L. Edwards told the 17th annual meeting of the American Association of Advertising Agencies in Washington May 22. Miss Edwards is executive secretary of the American Home Economics Association which numbers 9,000 women among its members. She is also chairman of the joint legislative committee of nine prominent women's organizations.

"The consumer is justified," said Miss Edwards, "in asking protection against many of the practices advocated before the Senate Committee by the manufacturers in connection with Bill S. 2800 (the Food and Drug bill). But sometimes it is true that the unethical and anti-social fringe of this group tries to dictate policies and practices. The result is that the consumer buys as little as she can. Changing advertising from the psychological to the factual appeal would help both advertisers and consumers."

CASE 71

United States News.

TO CURB FAKE ADVERTISING

Capper Offers Bill to Penalize Fraudulent Notices.

WASHINGTON, May 8 (AP).—Prison sentences or fines for fraudulent or misleading advertisements, to be prosecuted in Federal courts, were called for today in a bill introduced by Senator Capper of Kansas.

In a statement explaining the measure, which he said was based on the "Printers' Ink statute" in force in twenty-four States, Mr. Capper objected to the administration's reported plan to bring advertising under Federal control.

He referred to conferences recently conducted at the Agriculture Department on amending pure food and drug laws to go after misleading advertisers.

"How would a manufacturer be able successfully to advertise in a newspaper if he had to submit his copy to Washington for approval before running it?" asked Mr. Capper, a publisher himself.

CASE 72

The New York Times.

ized to provide consumers with information, claimed to be absolutely impartial and based upon laboratory tests, regarding various widely-advertised articles in common use. The information consists of reports on the comparative quality and prices of competing products.

Explain in your letters that you are studying consumer problems, mention the name of your school, and request enough circulars to distribute among students of the class for use in the notebooks.

Discuss the circulars in the light of the problems of wise budgeting suggested in this chapter, such as the difficulty of ascertaining the real merits of an article, fair values, and the pertinent facts in rival claims.

6. Can false and misleading advertising be justified on the basis that it produces a revenue for newspapers and magazines, and creates employment for thousands of people, such as printers, copy writers, artists, and others?

> **Think:** Is this a case of the make-work theory (see page 158)?

NEW 6% TIME PAYMENT PLAN

You can figure it out for yourself.

1 Start with your unpaid balance.

2 Then add insurance cost . . . at conference rates.

3 Then multiply by 6%—for a 12-month plan. One-half of one per cent per month for period more or less than 12 months.

In some states a small legal documentary fee is required. NO OTHER CHARGES.

$510

CASE 73

7. Refer to Case 73. The price is $510.00, of which $135.00 is paid

upon the signing of the contract. The insurance cost is $25.00. The balance is to be paid in twelve equal monthly instalments. What rate of interest do you really pay?

Think: $510.00 less $135.00 equals $375.00, the unpaid balance. Adding insurance increases this to $400.00. Multiplying by 6% and adding this to the total brings the total obligation up to $424.00. This total obligation may be looked upon as a loan made to you by the company. You agree to pay this loan by making twelve equal monthly payments of $35.33 each. Suppose that you make the purchase on January 1. On February 1, then, you pay $35.33, the first monthly payment. You have, therefore, borrowed $424.00 for one month and have then reduced the loan to $388.67. On March 1 you pay another $35.33; you have, therefore, borrowed $388.67 for one month and have then reduced the loan to $353.34; and so on. Summarizing the transactions for the entire twelve months, we have:

			$424.00	borrowed for one month.
Payment	No.	1,	$35.33;	388.67 " " " "
"	"	2,	35.33;	353.34 " " " "
"	"	3,	35.33;	318.01 " " " "
"	"	4,	35.33;	282.68 " " " "
"	"	5,	35.33;	247.35 " " " "
"	"	6,	35.33;	212.02 " " " "
"	"	7,	35.33;	176.69 " " " "
"	"	8,	35.33;	141.36 " " " "
"	"	9,	35.33;	106.33 " " " "
"	"	10,	35.33;	70.70 " " " "
"	"	11,	35.33;	35.37 " " " "
"	"	12,	35.37.	

The average amount borrowed during these twelve months is how much? For this accommodation you have paid $24.00. What, then, is the actual rate of interest?

8. (a) Suppose that the purchaser borrowed the $510.00 from the bank and took advantage of the cash price offered by the seller; how would the purchaser handle his promissory note or notes at the bank so as to confine his interest charges to 6%? (b) Why in question 7 is the actual interest somewhat more than 6%?

9. Under what conditions might a merchant be greatly benefited by the purchase of a delivery truck on the instalment plan, despite a high charge for the accommodation?

Think: How might the delivery truck save more than the costs of the instalment plan?

LAWS SOUGHT TO AID INSTALMENT VICTIMS

Higgins Plans Safeguards Here Against Abuses in Seizure and Auction of Furniture.

Greater protection for buyers of commodities on the instalment plan will be sought by the city in the next few days, it was disclosed yesterday by James A. Higgins, Commissioner of Accounts.

After investigating the practices of city marshals, Mr. Higgins found that many sellers of furniture and other commodities on instalments were taking advantage of their clients. He said he would discuss with Mayor O'Brien proposed changes in the law which would provide greater safeguards for the buyer.

City Marshal Charles Kemp of 165 East 121st Street admitted that he was receiving from $7.50 to $10 from each of half a dozen instalment houses every time he made a seizure. The law prescribes a fee of $1 for execution of these warrants.

Kemp seized furniture valued at $450 from Meyer Herscovitz after Herscovitz had paid $315 on his account. Herscovitz is the father of seven children, is unemployed and is receiving food tickets from the city. He bought his furniture from a Third Avenue concern.

Following such seizures, Mr. Higgins found the instalment houses conducted "auctions" in their own warehouses. Seized furniture was bid in by their employes at low figures to give the greatest possible deficiency judgment against the buyer.

Mr. Higgins said he intended to agitate and "keep on agitating" until city marshals were required to hold bona fide auction sales of seized articles in public places. He will try also to have the law amended so that any seizure is restricted to articles valued at the unpaid balance on any instalment contract.

CASE 74

The New York Times.

10. Refer to Case 74. Explain how a consumer may lose by having things repossessed that have been purchased on the instalment plan.

Conclusions.

A. What is a budget?

1. How does a budget help in managing one's affairs?
2. How is a budget compiled?
   (a) What estimates are necessary?
   (b) What statistics are helpful?
3. Explain how a budget book is used.

B. What is coöperative purchasing?

1. How is a coöperative society organized?
2. To what extent is this method of purchasing used here and abroad?

(a) What difficulties confront coöperative purchasing in the United States?

C. Name some of the difficulties of wise budgeting.

1. How can national advertising be helpful; how a hindrance?
2. How can instalment buying be helpful; how a hindrance?
3. Do you know of any agency that can help the consumer?
   (a) Tell what aids are given.

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Riley, pp. 31–33.

Advanced texts:

Ely, pp. 140–153.
Spahr, Vol. I, pp. 296–333; Vol. II, pp. 424–430.

Other books:

Harris, *Coöperation, The Hope of the Consumer.*

CHAPTER XIII

CHAPTER XIII

The Market Place

UNIT 1.—THE MARKET PRICE AND HOW IT IS DETERMINED

Observations and Discussions.

Noise, confusion, higgling without end—such are the successive impressions that greet one upon entering a market place.

Groups of traders congregate here and there and argue vociferously. Sellers know what they must receive, but try to get as much more as possible; buyers know what they can pay, but endeavor to save all that they can. And so the contest continues until, at length, a bargain is made. Then, for the moment at least, a *market price* is established and trading takes place at a figure probably somewhere between the hopes of the sellers and the ambitions of the buyers.

Whether it be the local market place where produce is received from the farms and bought by the local merchants, the New York Stock Exchange where stocks and bonds of the large corporations are bought and sold, or the various *produce exchanges* where certain commodities such as wheat, cotton, and coffee, daily change hands in vast quantities, the procedure is much the same. At the local market place, commodities and money are much in evidence, while in the large city exchanges, these are not seen. Nevertheless, in the latter as well as in the former, higgling goes on, market prices are determined in consequence, and exchanges follow. The fact that in the more formally organized exchanges the transactions are consummated on paper and deliveries of commodities or securities are left to times and places agreed upon does not in the least alter the principles involved. Nor does the fact that, in all but the very informal market places, the

trading is confined to brokers who are members of the exchange organization and whose business it is to execute the orders of their clients change at all the fundamental nature of the operations.

But a market place must not be thought of necessarily in such definite terms as either an informal gathering place of buyers and sellers or a formal organization maintained and operated by brokers. Every minute of the business day, by letters, telegrams and cablegrams, and telephone conversations, market prices are being determined that result in the exchange of goods and services of all sorts and kinds. Modern methods of communication have made every corner of the globe a market place.

1. If possible, a group visit should be made to a market place, or, if the club is located in a large city, to a stock or produce exchange. Appoint a committee to investigate the possibilities and, if it is the desire of the club, to make the advance arrangements in the usual way.

If you are able to visit a local market place, a stock or produce exchange, devote a page of your notebook to a description of a scene in which buyers and sellers meet, higgle over prices, determine upon a price, and trade.

As in the case of the clearing house, direct observation needs to be supplemented by a club demonstration. We need to slow down the operations, impose certain restrictions, and take certain liberties in order to make clear the steps that culminate in a market price.

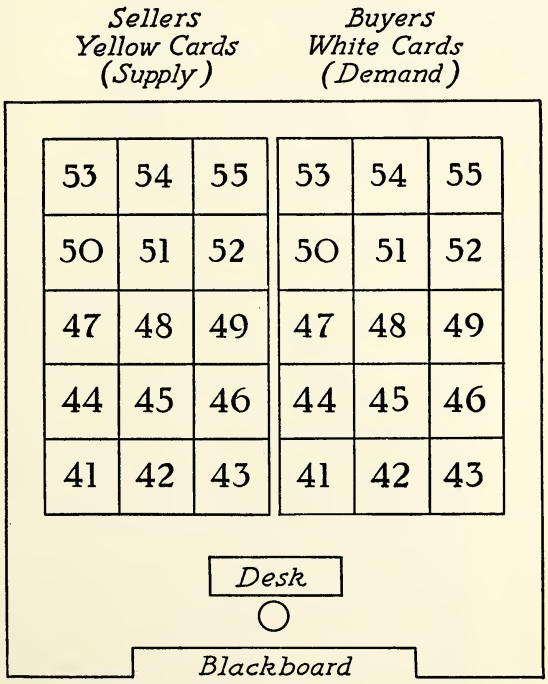
2. Appoint a committee of three to arrange a club demonstration showing how a market price is determined. Copy in your notebook the tables placed on the blackboard during the demonstration.

The first duty of this committee is to prepare cards—one for each member of the class. One half of the club members are buyers; the other half, sellers. The commodity offered and wanted is potatoes. Suppose that there are 30 members of the club, fifteen buyers and fifteen sellers. Fifteen white cards—one for each buyer—should be prepared, reading as follows: The first white card will read, "I will purchase one peck of potatoes for 41 cents or anything less than that

amount." The second white card will read, "I will purchase one peck of potatoes for 42 cents or anything less than that amount." The third white card will read, "I will purchase one peck of potatoes for 43 cents or anything less than that amount," etc., to the fifteenth card, which will read, "I will purchase one peck of potatoes for 55 cents or anything less than that amount."

Now prepare fifteen yellow cards or some color other than white—one for each seller. The first will read, "I will sell one peck of potatoes for not less than 41 cents." The second card will read, "I will sell one peck of potatoes for not less than 42 cents." The third card will read, "I will sell one peck of potatoes for not less than 43 cents," etc., up to the fifteenth card which will read, "I will sell one peck of potatoes for not less than 55 cents."

When the cards are distributed, the club will be arranged as indicated in the following diagram, the numbers indicating the prices on the cards held by the buyers and sellers:



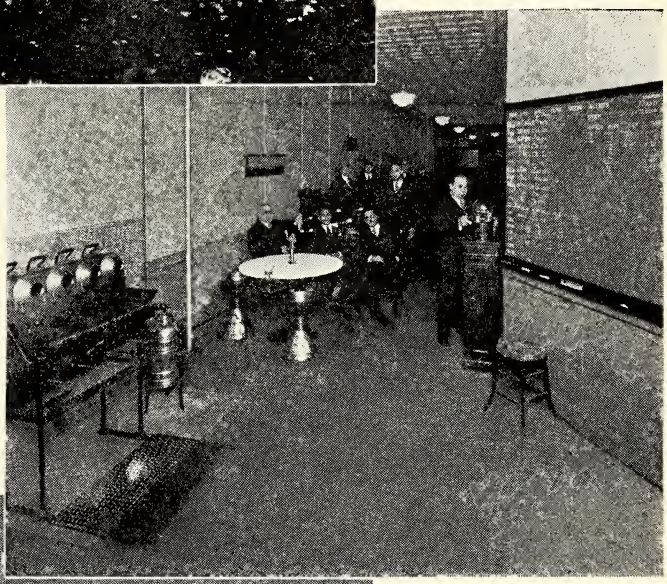
STUDENTS OBSERVING AN AUCTION SALE AT AN EARLY MORNING VEGETABLE MARKET.

Markets

A PUSH-CART MARKET.

STUDENTS OBSERVING THE UNLOADING OF FISHING SMACKS FOR AN EARLY MORNING FISH MARKET.

THE NEW YORK CURB STOCK EXCHANGE.



THE NEW YORK COFFEE EXCHANGE.

THE NEW YORK COTTON EXCHANGE.

It is now necessary to take certain liberties in order to make the demonstration clear. We assume, in the first place, that every trader is equal in ability with every other trader. This, obviously, is not true in the actual market place. We assume also that no trader will change his mind during the higgling process, a condition which is also quite unlikely in practice. Finally, because it is quite impossible for the club members actually to assume the mental attitudes and to experience the emotions of real traders whose very living, perhaps, depends upon the decisions they make, the market higgling is eliminated by letting all know what the disposition of each is in reference to a minimum or a maximum selling or buying price. This, of course, is not known in actual trading conditions, but is gradually discovered in the course of the higgling process.

Make a table on the board by asking your traders questions as follows:

> "At 41 cents how many will sell?" Obviously, only one seller will respond because out of the 15 possible sellers only one is willing to sell at as low a price as 41 cents.
>
> "At 41 cents how many will buy?" Obviously, all 15 buyers will respond because all are willing to buy for as low a price as 41 cents.
>
> "How many exchanges will take place at 41 cents?" Obviously only one.

Place this information on the board as follows: "At 41 cents there will be one seller and 15 buyers and one exchange will take place."

Repeat the question for 42 cents, 43 cents, 44 cents, etc., and complete the following table:

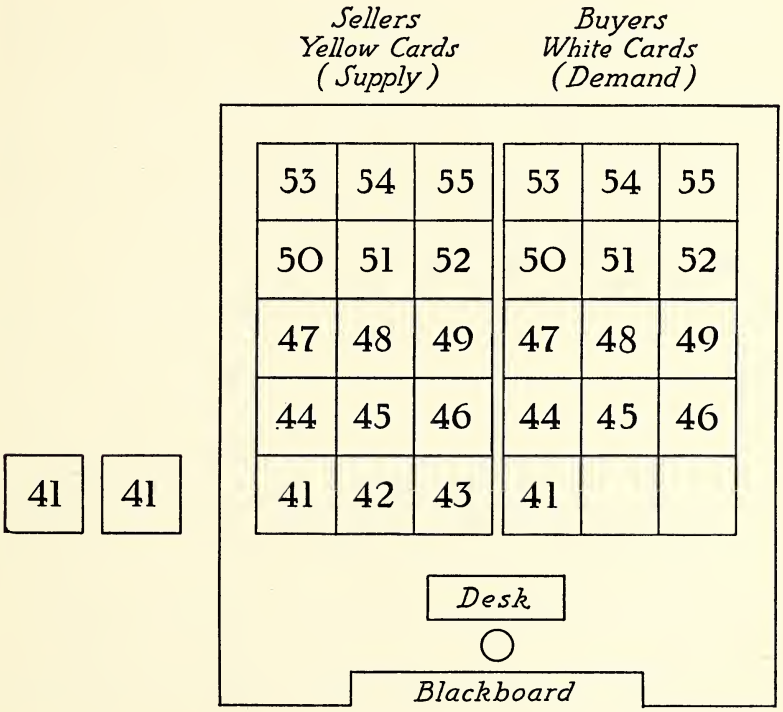
Price	*No. of Sellers*	*No. of Buyers*	*No. of Exchanges Taking Place*
41¢	1	15	1

3. The *market price* is the price at which the maximum number of exchanges take place. In this case what is that price?

Now let us alter the conditions by increasing the number of sellers, or the supply, and by decreasing the number of buyers,

or the demand. The buyer who will purchase at 42 cents or anything less and the buyer who will purchase for 43 cents or anything less will change their positions temporarily and stand beside the seller who will sell at not less than 41 cents. These two additional sellers likewise will sell at not less than 41 cents. It will be necessary to have two additional sellers' cards ready for these two additional sellers and to take away their buyers' cards.

The arrangement of the class will now be as follows:

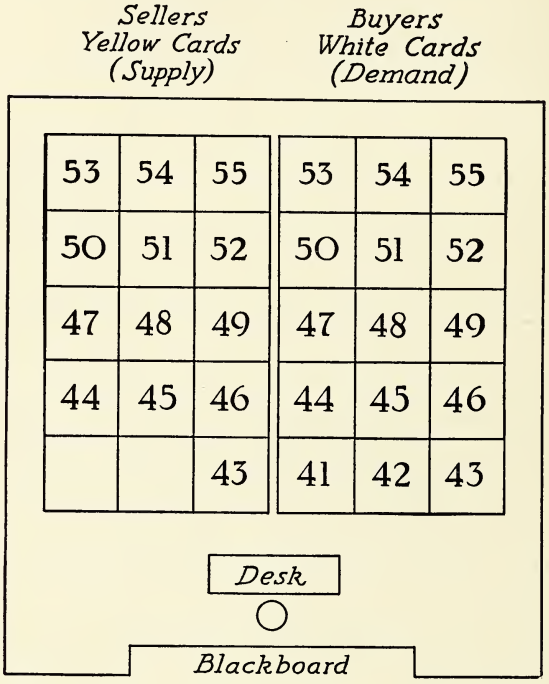


Now repeat the questions and complete the following table:

Market Price	*Sellers*	*Buyers*	*No. of Exchanges*
41¢	3	13	3

4. (a) What is the market price? (b) When the supply increases over the demand, how is the market price affected?

Now the two traders who changed their positions may go back to their first positions. Let us try still a third combination. Suppose the seller who will dispose of his product at 41 cents or anything over that sum and the one who will sell at 42 cents and over that sum drop out. The arrangement of the club will now be as follows:



Repeat the questions and complete the following table:

Market Price	*Sellers*	*Buyers*	*No. of Exchanges*
43¢	1	13	1

5. (a) What is the market price? (b) When the demand increases over the supply, how is the market price affected?

6. Before completing the demonstration, inquire: (a) At the market price of 49c, how many sellers would have been willing to sell for less? (b) How many buyers would have been willing to pay more?

When a seller disposes of his product at more than he is

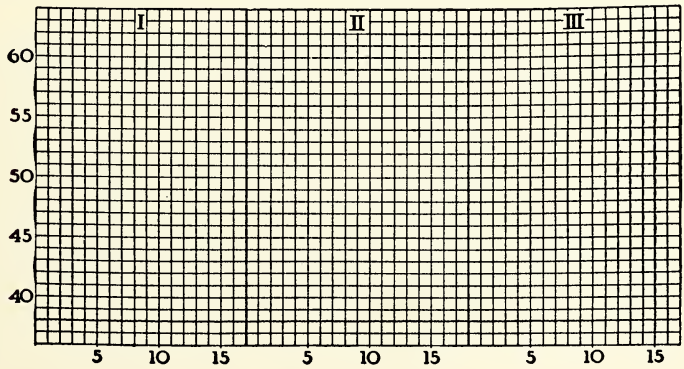
willing to accept, it is said that he has derived a *seller's surplus.* Likewise when a buyer purchases for less than he is willing to pay, he is said to derive a *buyer's surplus.* The higgling process so conspicuous in a market place is a contest between sellers and buyers wherein each tries to usurp the other's surplus. The seller who gains no surplus is called a *marginal seller,* and the buyer who gains no surplus is known as a *marginal buyer.*

7. Give an account from your own experience or imagine an experience (a) whereby you derive a seller's surplus, and (b) whereby you derive a buyer's surplus. (c) Are experiences such as these common in our economic life?

8. (a) A department store operating strictly on the "one price system" sets a price on a certain article. Few buyers are attracted. What will the management probably do after a time? (b) The same store offers an attractive novelty that is in great demand. Is the price likely to be set relatively high or low? (c) Is the "one price system" at variance with the principle of the market price? Explain.

9. Under competitive conditions such as we have been considering, do costs determine selling prices?

Make a chart in your notebook such as that shown in the accompanying illustration. Refer to the table of buyers' and



sellers' prices on page 226. Plot in section I of the chart a sellers' curve as follows: at 41¢, 1 seller; at 42¢, 2 sellers; at 43¢, 3 sellers, and so forth. In the same section, plot a buyers'

curve as follows: at 41¢, 15 buyers; at 42¢, 14 buyers; at 43¢, 13 buyers, and so forth. In section II of your chart, plot the sellers' and buyers' curve according to the table on page 227; and in section III of your chart, do the same with the table on page 228.

10. (a) How are market prices indicated on these charts? (b) Place your pencil over the sellers' supply curve in section I. Move your pencil directly to the right. What does this indicate has happened to the supply? (c) How does this compare with the supply curve in section II? (d) How is the market price affected? (e) Move your pencil directly to the left of its original position. What does this indicate has happened to the supply? (f) How does this compare with the chart in section III? (g) How is the market price affected? (h) Place your pencil over the buyers' (demand) curve in section I. Move your pencil first to the right, then to the left, and in each case state what changed conditions of demand are indicated and how the market price is affected. (i) Would it be possible for both demand and supply to change and the market price to remain the same? If so, explain how.

11. When a demand for goods exists without the ability or purchasing power necessary to buy, it is said that the demand is ineffective. Will ineffective demand affect the market price?

12. Refer to Cases 75 and 76. Why should corn prices soar, and wheat "break" (prices decline) under the conditions described?

13. Refer to Case 77. Select one or two items that have changed during the day's trading and explain what has happened.

14. Each of five brokers receives an order to buy 100 shares of Pennsylvania Railroad stock. The first broker is ordered to buy at not more than $48; the second, at not more than $49; the third, at not more than $50; the fourth, at not more than $51; and the fifth, at not more than $52. At the same time, each of five other brokers receives an order to sell 100 shares of Pennsylvania Railroad stock; the first to sell at not less than $48; the second, at not less than $49; the third, at not less than $50; the fourth, at not less than $51; and the fifth, at not less than $52. (a) What will be the market price? (b) Tabulate your results as suggested in the club demonstration. (c) Chart your results as suggested in question 10.

15. Refer to Case 78. When one product is a by-product of another, that is, produced in consequence of the production of the main product, the market price of the by-product will be influenced by the supply of the main product. Show that a large demand for nickel may reduce the market price of copper.

People trade because they desire one thing more than an-

WHEAT BREAKS AS RAINS COME

Steady Selling Knocks Prices Off 5⅝ Cents From Early Tops—Corn Lower

Steady waves of selling swung into the Chicago wheat pit Saturday with only momentary stop-gaps of buying power to stem the tide. Support was less aggressive than it has been of late and profit taking on the more moderate temperatures over the grain belt was larger. Chicago opened steady to a shade higher and promptly dipped 5⅝ cents from the top to close with net losses of 3½ to 3⅞ cents. Winnipeg was off 3⅜ to 3⅝ cents. Winnipeg finished off 3⅜ to 3⅝ cents.

CASE 75

Wall Street Journal.

CORN PRICES SOAR AS PESTS HIT CROP

Chinch Bug's Ravages Cause Heavy Buying, With Final Gains 2¼ to 3 Cents.

OTHER CEREALS GO LOWER

Rise in Yellow Grain Helps to Send Wheat, Rye and Barley to 1933 Tops Before Reactions.

Special to THE NEW YORK TIMES.

CHICAGO, July 5.—The chinch bug has become a big factor in the corn market. Reports indicating that the infestation in Illinois was the worst ever known, and had caused losses of 20,000,000 to 25,000,000 bushels in Southwest Iowa, sent prices skyrocketing to new high marks for the season and nearly 5 cents above the inside figures of the morning before heavy profit-taking checked the advance.

CASE 76

The New York Times.

COPPER LIMITS NICKEL'S PROFIT

Net Above $2 a Share Impossible Until "By-Product's" Price Goes Above 10 Cents

While International Nickel Co. of Canada will probably show earnings of more than $1.25 a share on the common stock after preferred dividends and all charges in 1934, the following analysis will show that, even with record nickel consumption, International Nickel will probably not show annual earnings of $2 a share until price of copper (its other main product) is above 10 cents a pound in the foreign market. Present price is around 7.30 cents.

CASE 78

Wall Street Journal.

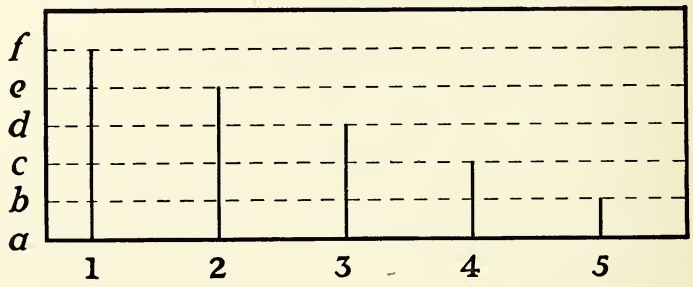
10:30 Stock Ticker Prices

	Prev. Close.	Today's Opening	10:30 Ticker
Allied Chemical..	136½	136⅜	136
American Can ..	96¾	96¾	97
Amer Smelting..	41⅛	41	41¼
Am Roll Mills ..	18⅝	18½	18½
Am Tobacco B..	74¾	74¾	75¼
Anaconda	14⅝	14⅜	14⅜
Atchison	57⅜	57½	57½
Balt & Ohio.....	23⅛	23	23
Beth Steel	33	32¾	32¾
Chrysler Corp ..	38⅞	38¾	39⅛

CASE 77

New York World-Telegram.

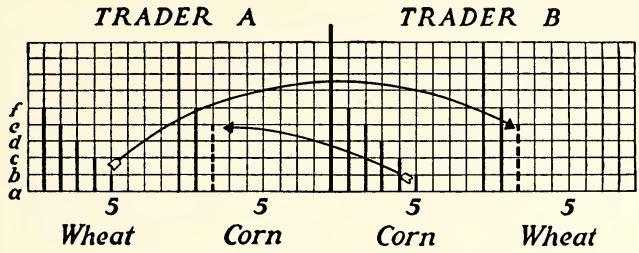
other. There is no measuring rod for these intensities of desire, such as inches, pounds, or quarts, but in general it may be said that the more units one possesses of a given article, the less intensity of desire will be felt for each unit. Suppose, for example, that a trader has five bushels of wheat and that these five bushels of wheat are represented by five lines, thus:



The heights of the lines represent, in general, the trader's intensity of desire for bushels of wheat. So long as he has five bushels, then, his intensity of desire for wheat is relatively slight, represented on the chart by the length of the line *ab*. If he had but four bushels, his intensity of desire for each bushel would be greater, in this case represented by the length of the line *ac*. If his stock were reduced to three bushels, his intensity of desire for each bushel would be represented by the length of the line *ad*. Had he but one bushel, his intensity of desire for that one bushel would be represented by the entire length of the first line, *af*. This intensity of desire is called *marginal utility*—"utility" meaning the power to satisfy a human want, and "marginal utility" being defined as the least utility attached to any one item of a "stock of goods."

16. Show that two traders with equal intensities of desire for wheat and corn, one possessing five bushels of wheat and one bushel of corn and the other possessing five bushels of corn and one bushel of wheat, may trade corn for wheat in such a way that when the transaction is complete each trader has increased the total utility to him of the commodities in question.

Think: If *A* gives *B* one bushel of wheat, *A*'s sacrifice is represented by what line? *B*'s gain is represented by what line? If, in exchange, *B* gives *A* one bushel of corn, *B*'s sacrifice is represented by what line? *A*'s gain is represented by what line? How does the net gain to *A* compare with the net gain to *B*?



17. Suppose in the above problem that the market conditions of supply and demand were such that two bushels of corn exchanged for one bushel of wheat. Such would be the case, for example, if the market price of corn were 50c per bushel and the market price for wheat, $1.00 per bushel. (a) How would this alter the results of the trade in the matter of utility gained for each trader? (b) Does the actual exchange ratio necessarily bear any relation to the relative gain in utility to the traders?

18. Does marginal utility determine the price one is willing to pay for an object?

Think: Marginal utility means intensity of desire and as such certainly has something to do with the price one is willing to pay. But will two people, each having exactly the same intensity of desire for an object, necessarily each offer exactly the same price for it? What other factor is involved? Does marginal utility alone, therefore, determine the price one is willing to pay?

UNIT 2.—THE PRICE SYSTEM

Observations and Discussions.

In 1776 Adam Smith, the so-called "father of economics," set forth a principle that has dominated our economic life for one hundred and fifty years. Adam Smith concluded that

NEW OPPOSES OLD SCHOOL

Subordination of Profit to Public Good Aim of Former—Sees Need for Cooperation.

A clash between two rival schools of business thought, one of which is composed of so-called conservative business men who are clinging to pre-depression principles and the other made up of those advocating "enlightened selfishness" in the belief that industry's best interests will be served by subordinating profits to the general welfare, is impending at the present time, George A. Renard, secretary-treasurer of the National Association of Purchasing Agents, said here yesterday. Mr. Renard's statement was based upon sentiments expressed by trade association executives and business men in reply to more than 400 letters sent out by him two weeks ago.

CASE 79

Reluctance of Farmers to Cut Acreage Threatens Adjustment Program.

COTTON YIELDS 'PADDED'

Administration Warns 'Avarice' Will Wreck Recovery Plan—Tobacco Growers Interested.

Special to THE NEW YORK TIMES.

WASHINGTON, June 28.—Recent sharp rises in the Exchange prices of wheat and cotton and the effect they were having on farmer acceptance of the agricultural adjustment program were causing grave concern at the Department of Agriculture today.

Reports were received that both wheat and cotton growers, enthusiastic over the prospects of a continuation of $1 wheat and 12-cent cotton, were evincing a reluctance to destroy 25 per cent of their cotton crop and to agree to cut their 1934 wheat acreage by 20 per cent, if called upon to do so by the Farm Adjustment Administration.

CITY TO INTENSIFY FIGHT ON BAD DRUGS

20 Unemployed Pharmacists to Join Inspection Staff in Drive on Illegal Sales.

A score of unemployed pharmacists will be added tomorrow to the inspection staff of the Health Department as a means to intensify the drive against cosmetic and other shops which have been selling illegally drugs and proprietary medicines and products of inferior quality.

CASE 80

Northern Tobacco Growers Act.

By The Associated Press.

WASHINGTON, June 28.—Enthusiastic support of the Agriculture Department's plan for pulling the tobacco farmer out of the mire of overproduction was reported today by the department from tobacco growers of Pennsylvania, New York and New England.

CASE 81

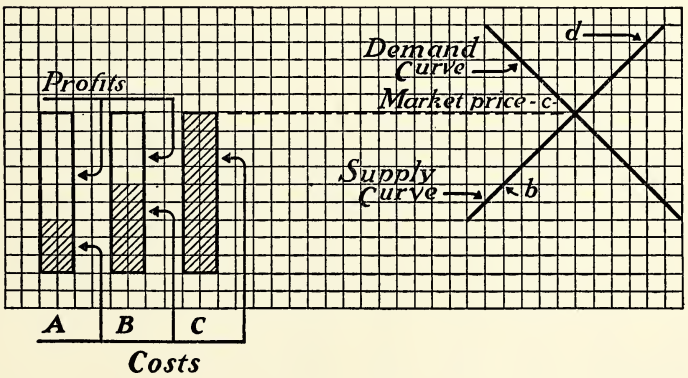
The New York Times.

society is guided by an "invisible hand" so ordering things that when each individual works to his own self-interest, the welfare of society is thereby assured.

1. Refer to Case 79. Is the viewpoint of the "new school" in accordance with the principle of self-interest set forth by Adam Smith?

2. Refer to Case 80. From this suggestion, develop an argument to disprove Adam Smith's conclusion.

According to the self-interest principle, the forces of supply and demand, considered in Unit 1 of this chapter, would assure a perpetual balance between production and consumption. Consider the following. At any given market price, a commodity is produced under a variety of conditions, and these conditions are reflected in costs. Some producers are more favorably situated than others, some have superior ability, and some have a greater amount of training, experience, or both. Costs, therefore, range all the way from the minimum, for those most favored, to the maximum, for those with the least advantages. Maximum costs equal the market price for the product, for, obviously, costs higher than this indicate an unprofitable venture. This condition is shown in the following diagram:



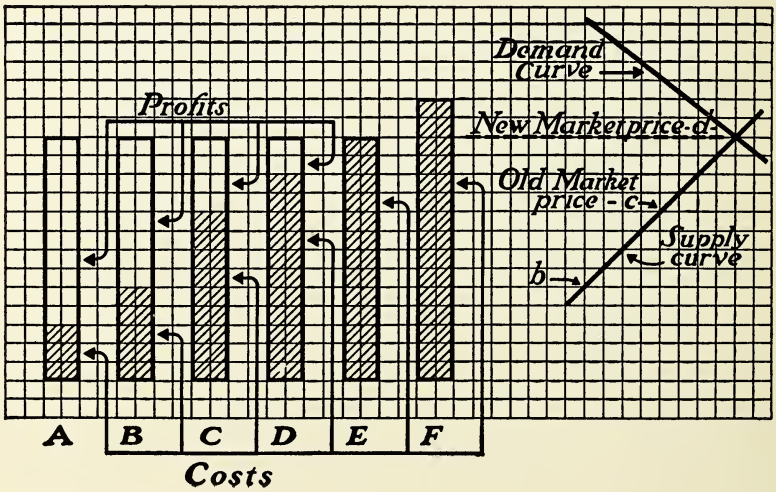
A, *B*, and *C* are producers. All sell their product at the market price. *C* is called the marginal producer because he

is selling his product at cost. *B* is making a slight profit. *A* is making considerable profit. Any number of producers with costs somewhere between those of *A* and *B*, and between those of *B* and *C*, might be shown. The term "costs" includes the amount paid for raw materials; the amount paid for all labor employed in the making of the product; all miscellaneous expenses, such as rent, heat, light, insurance, materials used in the upkeep of the factory, etc.; interest on borrowed capital at the current rate; remuneration to the owner or owners for their services, if they are actively engaged in the enterprise, at an amount not exceeding what they could obtain if employed elsewhere; and a return on their capital invested not exceeding what could be obtained if the capital were employed elsewhere.

3. (a) If the demand decreases while the supply remains the same, and, in consequence, the market price falls to "b," it will be to the self-interest of *C* to do what? (b) Who will then be the marginal producer? (c) What will be the condition of *A*?

4. If the demand increases while the supply remains the same, and, in consequence, the market price advances to point "d," in what condition will the producers find themselves?

Under these conditions, the industry would be a very profitable one. Other producers, actuated by their own self-



interest, would be attracted to it. Some would make a profit, others would probably remain for a while and then find it to their self-interest to discontinue. One or more would be in a condition of doubt whether to continue or to give up the new enterprise. At any rate, the community would be supplied with the additional quantity of the commodity demanded. This condition is shown in the above chart.

5. In the light of the automatic balance between production and consumption provided by the price system and the forces of supply and demand, explain the following circumstances:

(a) And Now Passes the Flatiron Age [1]

"After nearly three-quarters of a century of manufacturing flatirons, a Newark concern of wide reputation and high standing, Bless and Drake, has voluntarily placed itself in the hands of a receiver. Growing use of electric irons, together with Germany's and Belgium's ability to produce flatirons more cheaply than can be done by American factories, is the reason for the decline of this concern, once a leader in its line and now looking back at an honorable career."

(b) Pianos in a Crisis [2]

"Undoubtedly the radio, phonograph and automobile have taken the money that formerly went into the piano. The phonograph hurt the piano and the radio hurt the phonograph. The automobile has damaged the business of the radio, phonograph and piano. In time, all of these instruments will get into their legitimate places through the law of supply and demand, and all of them will prosper until such time as a new machine or instrument takes up the public fancy."

(c) The Radio Industry [3]

"The spread of this new adaptation of science to the American home immediately gripped the imagination of the masses and resulted in a demand for radio receiving sets, tubes, parts, and accessories. . . . Manufacturers of automobile accessories, electrical merchandise, hardware, clothing, gasoline engines, etc., became radio manufacturers almost overnight. Wholesalers and retailers in the same fields, as well as jewelers, barber shops, etc., became engaged in radio distribution. In addition, many new manufacturing companies were formed to make radios only, and exclusive radio wholesalers began to appear all over the country."

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[1] The *Newark Evening News.*
[2] *The Bay City Times Tribune.*
[3] Hamlin, Scoville, ed., *The Menace of Overproduction,* pp. 70–72.

6. How do you account for the failure of the automatic balance under circumstances such as those described in the following?

> "Except under pioneer conditions, where land and building materials are practically free, supply and demand, unaided, have never, at any time or at any place, furnished all classes of self-supporting families with a minimum health-and-decency grade of housing. Nor is there any reason to suppose they ever will." [4]

7. Refer to Cases 81 (page 234) and 82 and question 3 on page 197. Discuss the effectiveness of the automatic balance in the case of agriculture.

Brazil Pledges Continued Destruction Of Coffee Surplus, Allaying Alarm Here

Alarm over the slowing up of the destruction of coffee in Brazil was allayed in local trade circles yesterday when the New York Coffee and Sugar Exchange received a cable dispatch from the National Coffee Department of Brazil stating that there has been no change of policy. The alarm was caused by the fact that in the first half of February only 46,000 bags were destroyed, against a monthly average of 1,290,000 in the last six months of 1933.

CASE 82 *The New York Times*

As civilization develops, production is concerned more and more with the comforts and luxuries of life rather than with the mere necessities. Demand for these comforts and luxuries is more susceptible to fashion and sudden changes in the likes and the dislikes of the people than is demand for the more stable products. Furthermore, as standardized goods such as ready-to-wear clothing, furniture that everyone can use, mechanical devices for use in every home and office, etc., have come into use more and more, production has been carried on in advance of demand. Textile goods are made up in the hope that the new shades will prove popular; spring clothes are made during the winter months; automobiles are manufactured according to an estimated future sales schedule.

[4] Wood, Edith Elmer, *Recent Trends in American Housing*, p. 45.

8. (a) How are conditions such as these likely to affect the automatic balance? (b) Today does production respond to demand, or is demand more likely to be stimulated by producers in advertising campaigns, sales talks, and so forth?

When an advance in price causes a relatively large decrease in the demand, and a reduction in price causes a relatively large increase in demand, there is said to be an *elastic demand.* But when a change in price causes a relatively slight change in the demand, there is said to be an *inelastic demand.*

9. Divide a page of your notebook into two equal columns. At the top of the first column, plot the following demand curve:

Price	*Units Demanded*
$10.00	1
8.00	2
6.00	3
4.00	4
2.00	5

At the top of the second column, plot the following demand curve:

Price	*Units Demanded*
$10.00	1
8.00	3
6.00	6
4.00	9
2.00	12

Label your first column and chart "Inelastic Demand," and your second column and chart, "Elastic Demand."

Under conditions of inelastic demand, further maladjustments occur in the automatic balance. The modern manufacturer does not find it to his interest to reduce prices and maintain operations as pointed out in question 3 on page 236. Modern manufacturing is burdened with high fixed overhead costs, and this makes a difference. Consider the following:

10. A manufacturer's costs for a month are as follows: fixed overhead expenses, $14,000; labor, $4,000; materials, $2,000; total, $20,000. He is selling, let us say, 100,000 units at 20c each, every month—just enough to meet expenses. The demand for his product is inelastic. Let us say, for the sake of simplicity, that price reductions do not stimulate sales at all. (a) Under conditions of decreasing demand,

will it be better for this manufacturer to reduce the price 10% and maintain his full production, or to reduce his production 10% and maintain his full price? (b) So far as unemployment in the community is concerned, would it be better for this manufacturer to maintain price or to maintain production?

11. In the light of the following quotation, explain why the automatic balance is inoperative in governing the production of crude oil.

> "Most leases enjoin prompt drilling under penalty of forfeiture. . . . He [the lessee] knows that he must reach the oil sands quickly and produce as large a volume as possible or else the oil which lies below his property will flow to his neighbor." [5]

12. Note the following quotation and explain why the production of by-products is not subject to the control of the automatic balance:

> "About 70% of the income of the oil industry is derived from gasoline, and in the manufacture of sufficient gasoline a sufficiency of other products is a natural consequence. As a matter of fact, fuel oil has been largely overproduced in order to take care of the current overproduction of crude oil." [6]

13. Summarize eight reasons for the failure of the automatic balance in modern industry.

UNIT 3.—SPECULATION

Observations and Discussions.

Buying with no intention of taking delivery and selling without owning that which is sold seem at first thought little short of outright fraud. Yet thousands of such transactions take place daily on our commodity exchanges simply as a matter of routine business. For the most part, they not only are perfectly legitimate but perform a sound economic function. Indeed, it is entirely possible that if it were not for transactions of this kind, you could not buy a loaf of bread at the price you now pay.

Suppose that in October a cotton merchant buys from a grower, let us say, 100,000 pounds of cotton at 20¢. The transaction amounts to $20,000. The cotton is placed in a warehouse. The merchant does not wish to speculate; he

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[5] *Menace of Overproduction,* op. cit., pp. 18–19.
[6] *Ibid.,* p. 18.

desires only the legitimate profits of a middleman. He does, however, wish to insure himself against a possible loss due to a decline in the market price of cotton. Therefore he *hedges,* that is, he sells to a professional speculator 100,000 pounds of cotton at 20¢ for future delivery, say the following December. If, in December, the market price has declined to 15¢, the merchant will be able to buy a new order for cotton at this figure and turn it over to the speculator, who must purchase it for 20¢ according to the agreement arrived at in October. Thus far the merchant has profited, but the costs on his cotton in the warehouse must be charged or "written off" to 15¢. On this latter transaction, the merchant loses an amount equal to his gain in the hedging operation. Had the price of cotton advanced during the interval between October and December, the merchant in making good his delivery to the speculator, would have lost. On the other hand, he could have advanced the value of his cotton in the warehouse by the same amount.

The speculator, in his turn, assumes the merchant's risk. But this risk may be passed on. In fact the original order bought from the merchant in October may be bought and sold by various speculators hundreds of times before December arrives. These speculator traders are specialists. They study the market conditions, the crop possibilities, and possible sources of supply and demand at different periods with great care. Those who are particularly successful in predicting future movements show a profit at the end of the year. Their gains from buying and selling exceed their losses. Others not so successful show a loss. In any event, risks have been removed from the merchants and manufacturers, allowing them to devote their entire attention to their particular problems. The gains and losses have been distributed among a large number of individuals whose business it is to assume these risks.

1. Refer to Case 83. A milling company buys wheat at $1.00 a bushel. Three months will elapse before this wheat is sold as flour. In the meantime, the market price of wheat, and consequently the market price of flour, may change. Show how, through hedging, the mill-

ing company can protect itself against loss due to such market fluctuations.

Wheat Breaks on Steady Hedging Due to Heavy Crop Movement

Closes 2¼ to 2½ Cents Lower, With Stop-Loss Selling Uncovered and Buying Power Poor; Rains Forecast for Belt; Other Grains Decline

Special to the Herald Tribune

CHICAGO, July 2.—Wheat prices broke sharply on the Chicago Board of Trade today under steady hedging and stop-loss selling and finished at the bottom, 2¼ to 2½ cents lower than Saturday's close. The market was under pressure from the start and buying power was poor. Scattered selling by Southwestern houses uncovered stop-loss orders to sell and prices dropped swiftly.

CASE 83

New York Herald Tribune.

MARLAND URGES SHORT-SALES BAN

"Although there is something to be said in favor of short selling," Mr. Marland continued, "there is so much evil connected with it that it should be eliminated entirely. One of the worst forms of short selling is that done by an officer or director of a corporation 'against his box.' Knowing that the company's earnings are falling off and that soon it will publish a poor statement, some officials go technically short of their own stock on the theory that after the publication of the statement they can cover. Officers and directors who do this are deliberately cheating the stockholders of their own company and the public because they are in position to know of developments which are not available to others."

Mr. Marland also said that it

CASE 84

The New York Times.

Just as in the produce exchanges, so in the stock market professional speculation performs a real economic function. Mr. Richard Whitney, former president of the New York Stock Exchange, says this about professional stock speculation:

"The purchase and sale of securities on the New York Stock Exchange by speculators create a market where investors who hold securities may at any time turn them into cash. Only the securities which are active are considered as marketable and it is marketability which in turn allows investors to buy as many securities as they customarily do. Investments are purchased with the hope of a steady income and ultimate safety of principal. Each person naturally desires to secure the largest return, and therefore invests practically all of his capital. If all investments were illiquid and could not be turned into cash quickly, the investor would be like the business man with frozen assets. The ultimate value and the income-producing power of securities are not sufficient protection for the investor who knows that he may have to meet unexpected expenses. He must have a form of property which can, in an emergency, be converted into money. If securities could not be sold promptly, investors for their own safety would have to invest a smaller proportion of their fortunes in order to retain a proper reserve for emergencies. The market therefore gives to securities an attribute which they would not otherwise have. This attribute is of vital importance in a nation like our own where literally millions of people have invested in securities. The service rendered by the market is just as valuable to the community as that rendered by the retail merchant or distributor of goods who, by making it possible for persons to buy necessary commodities easily and conveniently, has assisted in the development of our country."

Speculation in the stock exchanges is carried on largely by means of short sales and marginal buying. If a speculator believes that the market price is too high on a certain security, he may sell some of that security even though he owns none of it. When the time comes for him to make delivery according to his contract for sale, he borrows the security from sources making a business of supplying such needs, and agrees to redeliver the security to the lender on demand. If the market price goes down, the loan can be paid at a cost less than the price at which the security was originally sold. If, however, the market price advances, the speculator must "cover" his *short sale* and loses in the transaction.

2. A speculator sells short a share of Pennsylvania Railroad stock for $50.00. He borrows the share of stock at a cost of $1.00 per month. In a month the stock declines to $45.00 per share and the speculator liquidates his loan. (a) How much profit has been made? (b) Show that short selling cannot permanently depress the market.

3. Refer to Case 84 (page 242). Explain wherein this is an abuse of short selling.

Marginal buying is the opposite of short selling. A speculator buys a security believing that its market price is too low and will advance. The security purchased immediately becomes collateral (security) for a loan. The speculator ad-

Odds 12 to 1 Against Amateur in Wall St., Mathematician Warns Columbia Students

Odds are greater than twelve to one against the "average man" making any spectacular profits or permanent gains in stock market speculation, Professor Carl N. Shuster, head of the mathematics department of the State Teachers College, Trenton, N. J., declared yesterday in an address at the Summer session of Columbia University.

Professor Shuster pointed out that the amateur speculator faced the keen competition of corporation officials, floor traders and specialists who could take advantage of the "slightest fluctuations" of the market.

"The best thing for the average

CASE 86

The New York Times.

SEEKS TO CLARIFY THE WORD "MARGIN"

Stock Exchange Observes Some Uses of Terms Which Are "Wholly Untrue and Misleading"

The New York Stock Exchange in a letter to members is calling attention to use of the word "margins," particularly in dealings with customers and the public in connection with discussion of the National Securities Exchange bill. To state that the House bill requires a 45% margin, the letter states, is misleading, because margins are calculated as percentages of the customer's debt.

Taking for example, a security purchased at $100, on the basis of the current bill the customer's equity would be $45 and his debt $55; therefore, the margin would be 45 divided by 55 or 81%, the letter states.

The letter of the Exchange, signed by Ashbel Green, secretary, follows:

CASE 85

Wall Street Journal.

vances only the difference between the purchase price and the amount of the loan. If the market advances, he can sell the security for a profit. If, however, the market price goes down, he may be called upon to add to his collateral. Failing to do this, the securities are sold at the market price, whatever that may be, and the speculator stands to lose not only that which he has advanced, but possibly more.

4. Refer to Case 85. Suppose the customer paid 6% for the loan in question and in one month sold the stock for 105. (a) How much would he profit by the transaction? (b) What percentage would he make on the actual amount of cash invested for the one-month period?

Speculation is the business of a specialist, and, as such, it has a sound economic function despite the fact that the methods used are many times open to question. It is a difficult matter for society to gain the advantages of speculation without leaving the way open for abuses.

5. Refer to Case 86. What does Professor Shuster say about the possibilities of the amateur speculator making a profit?

Conclusions.

A. Given the maximum buying prices and minimum selling prices of a given number of traders, how can you tell at what point the market price will be established?

1. What is a buyer's surplus? A seller's surplus?
   (a) Why is it that a rich man need pay no more for a loaf of bread than a poor man pays?
2. Do costs determine selling prices under competitive conditions? Explain.
3. Explain how the laws of supply and demand operate in the case of a by-product.
4. Can the market price of some products decline in the face of an advancing price level? Explain.
5. What is meant by marginal utility?
   (a) How may a trade benefit both parties?
   (b) Does marginal utility determine price?

B. What was Adam Smith's philosophy of self-interest?

1. How, according to this theory, should society always be furnished with its needs?

2. Explain the situation as it actually works out under the circumstances suggested below:
   (a) Socially undesirable goods that can be made at a profit.
   (b) Socially needed goods that cannot be produced at a profit.
   (c) Agricultural products.
   (d) Goods in the luxury class.
   (e) Goods made in advance of demand.
   (f) Manufactured goods having an inelastic demand.
   (g) The products of certain natural resources.
   (h) The case of by-products.

C. How does speculation serve a useful economic function?

1. What is hedging?
   (a) How does it benefit consumers?
2. What is short selling?
   (a) What useful function does it perform?
   (b) How may it be abused?
3. What is trading on margin?
   (a) What are its benefits?
   (b) What are its dangers?
4. What is the difference between professional and amateur speculation?

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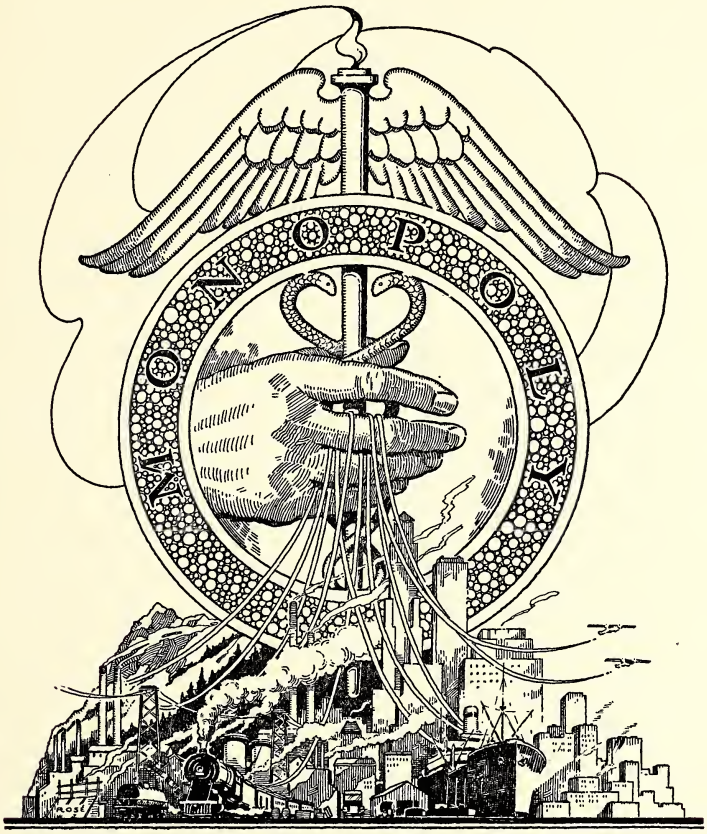
CHAPTER XIV



CHAPTER XIV

Monopoly

UNIT 1.—KINDS AND EXTENT OF MONOPOLISTIC POWER

Observations and Discussions.

Strictly speaking, *monopoly* indicates control of the entire supply of a commodity or service. Various circumstances may bring this about and one way to judge the social advantages or disadvantages of a monopoly is to consider these circumstances.

1. By reference to the table on the following page, classify the monopolies given below according to this outline:

I. Social monopolies.
   A. General welfare group.
   B. Special privilege group.

II. Natural monopolies.
   A. Limitations of raw materials.
   B. Secret processes.

(a) companies owning patents and copyrights, (b) the tobacco monopoly operated by the French government for revenue purposes, (c) the semi-State monopoly in Sweden which controls the manufacture, importation, and wholesale trade of wines and spirits, (d) the combination of window glass manufacturers that once existed in the United States because of the high protective tariff on this product, (e) monopolies that existed in the United States because of special rebates allowed them by the railroads, (f) the Kimberley diamond mines of South Africa that virtually control the production of diamonds, (g) the manufacturer of so-called Oxford or India paper by a secret process.

The third class of natural monopolies, comprising those that arise because of peculiar properties inherent in the busi-

CLASSIFICATION OF MONOPOLIES ACCORDING TO THE SOURCE OF MONOPOLY POWER[1]

I.

Social Monopolies

(Those which derive their monopoly powers fundamentally because of social arrangement)

A. General Welfare Group	*B. Special Privilege Group*
(Those which derive their monopoly powers solely because of social arrangements due to legislative enactments.)	(Those which derive their monopoly power indirectly because of social arrangements due to legislative enactments, or through social arrangements in the form of special privileges and advantages granted by other monopolies.)
1. Legislative enactments allowing the creation of { Patents, Copyrights, Trade-marks }	1. Monopolies based on public favoritism, such as a monopoly in one country protected by a high tariff from the competition of producers in other countries.
2. Legislative enactments that create *public consumption monopolies*. These monopolies are designed to regulate the consumption of certain commodities.	2. Monopolies based on private favoritism, such as those once created by special privileges granted by railroads.
3. Legislative enactments that create *fiscal monopolies*. These are created to obtain public revenue.	

II.

Natural Monopolies

(Those which acquire their monopoly power fundamentally because of their own inherent properties)

A. Limitations of Raw Materials	*B. Secret Processes*	*C. Peculiar Properties Inherent in the Business*

[1] Ely, Richard T., *Outlines of Economics,* 5th edition, pp. 560–561.

ness, is particularly important because of the fact that these properties are coming more and more to be characteristic of all large-scale industry. What these characteristics are can be seen at first hand in any telephone exchange.

2. Discuss at a club meeting the possibilities of a group visit to the local telephone exchange. If the trip is possible, appoint a committee to make the advance arrangements as usual.

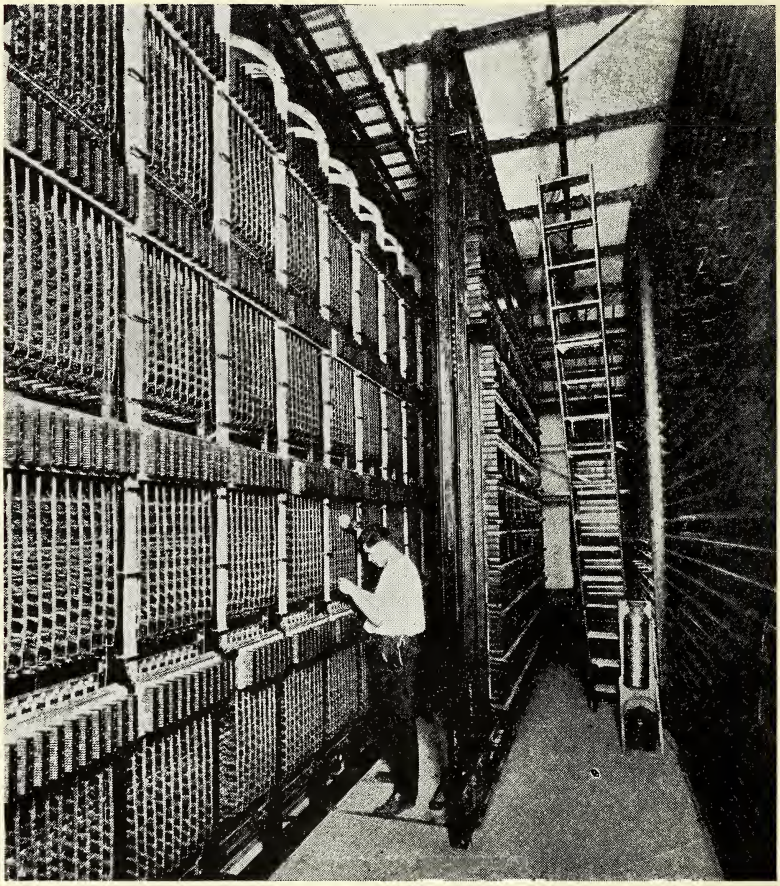
As you observe the exchange in operation, note specific items of fixed and specialized capital. Consider, in general, what expenses the telephone company must meet regardless of the volume of traffic.

Back of the simple little telephone instrument, resting on the desk of an office worker and connected with the outside world only by a harmless looking wire, is a vast amount of highly specialized capital. Interest must be paid on this capital regardless of whether the volume of telephone traffic is large or small. Likewise, the equipment must be maintained, insured, and to some extent manned, no matter whether business is good or bad. In other words, the telephone company is faced with a high proportion of fixed overhead expenses.

This means that a large volume of business is necessary merely to meet expenses. A little over that essential amount may return good profits, but a little under will certainly mean huge losses. In the few communities where two or more telephone companies compete, the same conditions apply to each company. The temptation is great, therefore, for a company that needs additional volume of business to cut its rates in order to attract more subscribers. Other companies must follow suit or lose business. Then the first company must go a step farther. A rate war follows and is likely to continue until no company is receiving sufficient revenue to meet its costs. Under such circumstances, efficient service cannot be maintained and the public suffers in consequence. This is called *destructive competition.* When a non-essential commodity or service is so involved, the inconvenience is not so serious to the public, but when an essential industry is affected, the entire economic life of the community is involved.

These conditions are not peculiar to the telephone company. They are found also in such industries as railroads,

canals, and telegraph communication, while many local public utilities having to do with electric lighting, water distribution, the production of gas, and the operation of street railways



Behind the Switchboards in a Telephone Exchange.
Note the large amount of fixed and specialized capital suggested in the picture.

present situations of a similar nature. A large measure of monopolistic control will be found in all of these activities, because characteristics inherent in the undertakings make competition self-destructive.

3. List the social advantages and disadvantages of granting patents and copyrights.

4. Refer to Case 87. Do you think that Mr. Borah is justified in a wholesale denunciation of monopolies? Why, or why not?

5. What justification is there for a municipality to grant a franchise to a private company allowing that company the exclusive right to operate cars on the streets of the municipality?

Borah Scores Big Combines as Hindering U. S. Recovery

Senator Tells Idaho Picnickers That Monopolies by Price-Fixing Gouge Public and Bottle Up Prosperity from the Masses.

By the Associated Press.

ST. ANTHONY, Idaho, July 24.—Senator Borah (R., Idaho) called for the destruction of monopoly today, denouncing it as "the most insidious and most successful enemy of the New Deal."

Flinging down the gauntlet to "defenders of monopoly," the Idaho Senator told an annual Pioneer Day audience "They will have to fight in the open."

His address bristled with epigrams:—"Monopolies are economic Hitlers." . . . "The effect of monopoly is to decrease, if not to destroy, purchasing power." . . . "The farmer can never win out on that basis." . . . "Monopoly has no more right to exist than any other form of depredation."

CASE 87

New York World-Telegram.

An organization enjoying monopolistic power may be privately owned and operated for the benefit of certain individuals, or it may be publicly owned and operated for the benefit of all. Its sway may be limited to a restricted area, such as a municipality, or may extend over an entire nation or even the whole world. These circumstances also must be taken into consideration in judging the social character of a monopoly.

6. What justification might be cited for public ownership of natural monopolies arising out of the limitations of raw materials?

7. Discuss the advantages and disadvantages of public ownership of local natural monopolies arising because of peculiar properties inherent in the business, such as those discussed in the case of the telephone company.

Think:

Advantages	*Disadvantages*
Reduced costs because of absence of the profit motive.	Profit motive is necessary for efficiency.
Better service because only interests of the public need be considered.	Positions would be filled as a reward for political favors.
Greater public interest in political matters because more is at stake.	Needless for the public to assume the risks of a business undertaking when private individuals are willing to do so.

8. It is said that out of over 300,000 non-financial corporations existing in 1929, 200 of the largest of these controlled nearly one-half of all the non-banking corporate wealth in the country. Approximately 2,000 men were directors of these 200 corporations. Since an important number of these directors were inactive, the ultimate control of nearly half of industry was actually in the hands of a few hundred men.[2] How does this concentration of economic power make relatively easy the creation of monopolies?

9. Picture the extent to which monopolistic control has been attained in the important industries of the country as follows: [3]

Prepare a chart such as that shown in the sketch on the next page. Considering each circle 100%, divide the twelve circles in accordance with the percentages given in the twelve following statements. Color the portions of the circles representing the given percentages. Divide these colored portions according to the number of companies mentioned in each statement. Entitle each circle appropriately.

"Four companies produce one-half of the annual output of anthracite coal."

"Four companies control one-half of the copper reserves."

"One company owns more than 90% of the known nickel reserves in the world."

---

[2] Berle and Means, *The Modern Corporation and Private Property,* pp. 28, 46.

[3] Laidler, Harry W., *Concentration of Control in American Industry,* pp. 434–440.

"Five companies produce about 35% of the total production of oil."

"Two corporations control 52% of the steel-making capacity."

"One company controls four-fifths of the telephone service of the country."

"One company has jurisdiction over three-quarters of the telegraph service."

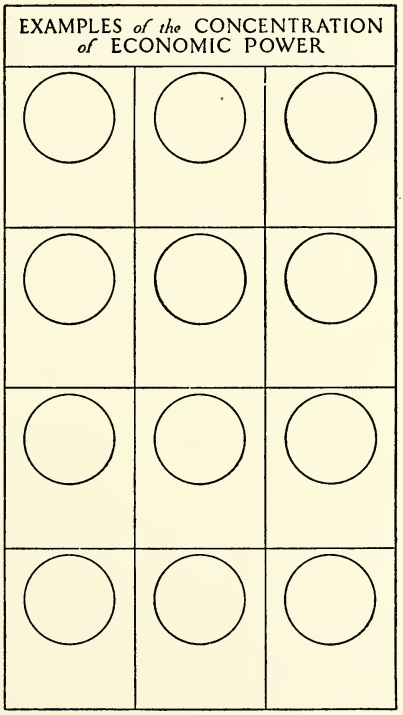
"Two companies sell nearly three-quarters of the motor cars."

"Two packers handle 50% of the meat entering interstate commerce."

"Four companies supply one-quarter of the nation's bread."

"Two companies manufacture more than half of the equipment for the electrical industry."

"One company supplies one-half of the agricultural machinery."



Industry today tends to reach out towards monopolistic control in three different ways. Companies are termed vertical,

horizontal, and circular trusts according to which course is pursued. The *vertical trust* is one that seeks to control every element that enters into its finished product, from the obtaining of the raw materials to the making of deliveries to ultimate consumers. Figuratively expressed, it controls its product from the ground up. For example, an automobile company might conceivably own its own iron mines, its mills for the production of steel, its ships for transportation purposes, its sources of lumber, paint, glass, etc., in addition to its factories and retail distributing centers. A *horizontal trust* endeavors to absorb or to control all producers making a given product. Thus, if all manufacturers of radio sets were brought within the network of a holding company, this could properly be termed a horizontal trust. A *circular trust,* on the other hand, does not confine itself to any one product, but reaches out to include within its organization products which are of a similar nature in the matter of manufacturing technique or which can be distributed to ultimate consumers by means of the same marketing organization. Suppose, for example, that all electrical goods from motors to electric toasters were manufactured by one concern; this, then, would be a circular trust. Any one trust, of course, may exhibit some aspects of two or even all three of these types.

10. By means of the following quotations, identify a circular, a horizontal, and a vertical trust.

> "The United States Steel Corporation controls one-half to three-fourths of the iron ore reserves and two-fifths of the industry's steel-making capacity." [4]
>
> "It is inevitable that the business of the country shall be done by very large companies which reach back to the source, and, taking the raw material, carry it through the necessary stages to the finished state. Just as soon as a business gets beyond a certain size the control of the materials has to be absolute, for, regardless of costs, it is not otherwise possible to avoid the stoppage of strikes or the advent of unskilled management." [5]
>
> "For some time past we had successfully merchandised several nationally advertised products through one sales organization,

[4] Laidler, Harry W., *Concentration of Control in American Industry,* p. 436.
[5] *Ibid.,* quoting Henry Ford, p. 444.

and the experience created the conviction that an efficient organization, national in scope, could maintain the jobber, chain and retail contacts and widen its field by the addition of several new products, and at the same time do justice to each of them." [6]

UNIT 2.—MONOPOLISTIC PRACTICES

Observations and Discussions.

A monopoly price is usually thought of as a high price, but this is not always the case. Maximum profits are desired, and these may be obtained under some circumstances by charging a high price per unit, but under other conditions a low price per unit may yield greater returns. In any event, the monopoly cannot at once fix its price at the most advantageous point. It must first discover the nature of the market for its product by experimenting with various prices and noting what demand develops at each level. Then, knowing the cost per unit of its product at various production levels, the monopoly can determine upon the most advantageous price and gauge its production accordingly.

1. **Suppose, for example, that the following conditions prevail:**

Price	*Quantity Demanded*	*Cost per Unit*
15	100	8
12	200	6
8	300	5
5	400	4
1	500	3

At a price of 15, the monopoly can sell 100 units. The total income, then, will be 15 x 100, or 1500. At a production level of 100, the cost will be 8. This makes a total cost of 8 x 100, or 800. The profit will be 1500 — 800, or 700. At a price of 12, the monopoly can sell 200 units. The total income will be 12 x 200, or 2400. The cost per unit will be 6, and the total costs 6 x 200, or 1200; the profit, 2400 — 1200, or 1200. Continue this process and find the price that will net the greatest return.

2. **In a similar manner, calculate the most profitable price under the following conditions:**

---

[6] *Ibid.*, quoting Colby M. Chester, Jr., president of the General Foods Co.

Price	*Quantity Demanded*	*Cost per Unit*
16	100	8
15	200	6
14	300	5
13	400	4
12	500	3
11	600	2
8	1000	1
7	1200	1
6	1500	1

3. (a) Plot the demand curves in questions 1 and 2 and determine in each case whether the nature of the demand is elastic or inelastic. Examine the cost curves and determine whether the costs are increasing, decreasing, or constant. (b) A demand curve, as well as a cost curve, may take an innumerable variety of forms making an infinite number of combinations possible. In general, however, under conditions of decreasing costs and an inelastic demand, will a monopoly price be high or low? (c) Under conditions of decreasing costs and elastic demand, will a monopoly price be high or low?

4. Keeping in mind that the demand for the necessities of life is inelastic while the demand for luxuries is elastic, which do you consider to be more serious, a monopoly on bread, or a monopoly on diamonds? Why?

5. Refer to Case 88. Is it always to the interest of monopolies to force the public to pay high prices? Explain.

6. Suppose that a monopoly, under the conditions cited in question 2, manufactures a total quantity of 1500 units, but reserves only 600 of these for the domestic market where monopolistic conditions are enjoyed and *dumps* the rest abroad where, under competitive conditions, they sell for 3. (a) How much will the transaction yield? (b) How much more or less profitable is this than selling the entire 1500 in the domestic market?

> **Think:** If the quantity offered in the domestic market is limited to 600, what price can be had? What will be the total sales for this 600? How many units of the product are left unsold? If these are "dumped" abroad at 3, what will be the total sales abroad? The total sales here and abroad, then, amount to how much? The costs for 1500 units manufactured at one time are how much? What is the profit? Compare this with your answer to question 2.

7. Refer to Case 89. Explain under what circumstances this could happen.

CHECK ON MERGERS URGED BY DONOVAN

Assistant to Sargent Pictures to Bankers the Steady Growth of Combinations.

Special to The New York Times.

QUEBEC, June 22.—Addressing the convention of New York State bankers here today, William J. Donovan, Assistant Attorney General in charge of trust prosecutions, asserted that there was a strong indication that diffusion of stockholders is being employed for the increase of combinations and the growth of monopolies. These monopolies were not directed, as were those of the '90s, to destroy competition, he said, but to force the public to pay higher prices.

CASE 88

SENATORS SEEK DATA ON PRICE CUTS ABROAD

Farm Bloc Members Ask Trade Commission About Dumping of American Goods.

Special to The New York Times.

WASHINGTON, March 25.—Farm bloc Senators asked the Federal Trade Commission today for information as to corporations being formed abroad by Americans that would violate the anti-trust laws. This grew out of their contention that certain American manufacturers are dumping surplus products abroad below home market prices.

CASE 89

The New York Times.

8. How might a publisher of a set of books make a greater profit by marketing two editions, identical in every respect except, perhaps, the binding, at an interval of, say, six months rather than by marketing only one edition of the entire printing?

UNIT 3.—GOVERNMENTAL CONTROL

Observations and Discussions.

In 1890 the Federal government passed legislation designed to prevent the formation of monopolies. The legislation took form in the Sherman Anti-trust Act. Combinations in restraint of trade, whether in the form of trusts or otherwise, were prohibited under severe penalties. The Act declared it to be an offense: "to establish or attempt to establish a monopoly, or to combine or conspire—to establish a monopoly

of commerce between the several states or in the foreign nations."

The Sherman Act was supplemented in 1914 by the Clayton Act. This law prevented one company from acquiring shares in another company if, by so doing, the action led to "a real diminution of the competition between the companies," or tended "to establish a monopoly." It prohibited price discrimination between different purchasers having as its object the lessening of competition or the creation of a monopoly. It made illegal the giving of discounts or rebates on condition that the buyer should not use or deal in the goods of competitors. Provisions were also stipulated wherein the holding of posts simultaneously in different companies by directors and employees was prohibited.

Certain provisions of both the Sherman Act and the Clayton Act were set aside by the passage in 1918 of the Webb-Pomerene Act. This Act exempted from the provisions of the first two Acts "an association entered into solely for the purpose of engaging in export trade."

1. Prepare a three columnar table in your notebook. Under the captions "Date Passed," "Name of Law," and "Purpose of Law," summarize the legislation in the United States dealing with monopolies.

2. Do you think that the Webb-Pomerene Act is inconsistent in any way with the earlier acts? Why, or why not?

In 1920 the Federal government brought legal action against the United States Steel Corporation. The government contended that it:

> "was a combination in restraint of trade, because it is not the result of natural trade growth, but is a mere instrumentality for combining competing corporations which together occupy an overwhelmingly predominant position in trade and commerce in iron and steel products generally." [7]

In arriving at its decision, the Supreme Court reviewed the business practices of the corporation and found that the corporation had not in any way engaged in unfair business prac-

[7] Laidler, *op. cit.*, p. 407, quoting 251 U. S. 423.

tices such as securing freight rebates, creating an artificial scarcity of its products, oppressing competitors, and the like. The Supreme Court refused to order the organization dissolved.

One judge dissented from the majority opinion. He said:

> "From the earliest decisions of the court it has declared that it was the effective power of such organizations to control and restrain competition and freedom of trade that Congress intended to limit and control. That the exercise of the power may be withheld, or exerted with forbearing benevolence, does not place such combinations beyond the authority of the statute which was intended to prohibit their formation, and when formed to deprive them of the power unlawfully obtained."

3. (a) What new element in the interpretation of so-called anti-trust laws is suggested in this decision? (b) Do you think that the government has grown more tolerant or less so in the matter of combinations of corporations? Give reasons for your answers.

> **Think:** The law said: all combinations in restraint of trade are forbidden. The court said: this particular combination has been fair with its competitors. The dissenting judge said: the law forbids such combinations regardless of whether they happen to be fair with their competitors or not.

During the years 1879–1884, the railroads were guilty of grave offenses. Freight rates were advanced to pay dividends on watered stock, taxation was evaded by influencing legislators, and certain localities and shippers were favored by low shipping rates. In 1887 Congress responded by creating the Interstate Commerce Commission. The commission consists of five members appointed by the President, and is given power to supervise all interstate railroads.

Another commission came into being in 1914 by virtue of the Federal Trade Commission Act of that year. Five members appointed by the President constitute this body. It is charged with the responsibility of investigating and reporting on the organization and conduct of corporations alleged to be infringing the anti-trust laws, and of preventing unfair competition.

In 1907 a new type of state commission appeared first in New York State and then in Wisconsin. It was assigned the duty of controlling the rates of local public utility companies,

New Campaign For Enforcing Anti-trust Laws

Action by Trade Commission Against Price-fixing and Combinations in Restraint Of Free Competition

This past week the Commission attacked its trade regulating job in earnest and handed down a whole batch of complaints orders against companies alleged to be colluding in violation of anti-trust laws.

It did these things:

Charged 10 companies making most of the Nation's viscose rayon yarn with conspiring to form a price-fixing monopoly. Twenty-two members of an accounting firm also are named, the Commission claiming they aid in maintaining fixed prices by making special audits. The companies are said to have punished price-cutters of rayon cloth by maintaining a cloth-making concern of their own.

Charged Crown Zellerbach Corp., San Francisco, a large holding company of the paper and paper products industry, with acquiring a competing company by stock purchases. Thus it was able to control 80 per cent of the Pacific Coast output of newsprint, says the Commission. The case will go to trial soon.

CASE 90

United States News.

and of enforcing the rendering of adequate service. Such bodies have come to be known as "public service" or "public utility commissions." The establishment of commissions of this kind has spread rapidly throughout the country, the object being to preserve the advantages of "initiative and ef-

ficiency" of private ownership and management, while, at the same time, establishing control for the protection of the public.

4. Prepare a three columnar table in your notebook. Under the captions "Date Established," "Name," and "Purpose of Commission," summarize the public agencies that have to do with the control and regulation of monopolistic enterprises.

5. One source of monopolistic power came to an end with the Interstate Commerce Commission. What was it?

6. Refer to Case 90. Describe some of the recent activities of the Federal Trade Commission.

7. Contrast the work of the Interstate Commerce Commission and the state public utility commissions.

Conclusions.

A. What test would you apply to find out whether or not a given company were a monopoly?

1. What would you want to know about a monopoly to judge its social character?
   (a) Are all monopolies harmful?
      (1) What kind of monopolies would you advocate if any?
      (2) What kind of monopolies would you condemn if any?
   (b) Name a governmental monopoly and a privately owned monopoly.
      (1) Would you like to see one or the other wiped out, or do you think that each has its place?

2. It is sometimes said that the effects of destructive competition and the increasing concentration of economic power are forces working to create monopolies.
   (a) What is destructive competition?
      (1) Why is it more important today than a hundred years ago?
   (b) What evidence can you cite of the existence of a concentration of economic power?
      (1) What forms of business organization make this concentration possible?
   (c) To what extent are monopolistic conditions found in the chief industries of the United States?
      (1) In what ways does industry attempt to reach out towards monopolistic control?
         a. Name and give examples of the different kinds of "trusts."

B. Is a monopoly price always a high price?

1. Under what conditions is it likely to be?

2. What advantage does a monopoly gain by "dumping"?
   (a) Explain the process.
3. How may a monopoly gain the same advantage by making some slight difference in the product and selling each part at different times?
   (a) Explain the process.

C. To what extent are monopolies controlled in the United States?

1. What laws have to do with monopolies?
   (a) Has the government become more tolerant or more severe in its attitude towards monopolies during recent years? Why?
2. What governmental agencies have to do with the control of monopolies?
   (a) Explain the function of each.

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CHAPTER XV

CHAPTER XV

Foreign Goods

UNIT 1.—THE ADVANTAGES OF INTERNATIONAL TRADE

Observations and Discussions.

For the growing of cane sugar, nature favors Cuba, while the Canadian Northwest is one of the most favored regions for the raising of wheat. Brazil is well adapted to the production of coffee, but is lacking in coal deposits. It is a matter of common knowledge, too, that many tropical countries can grow a variety of fruits and vegetables which can be raised in colder regions only at prohibitive expense. Nature has distributed advantages—albeit unevenly—over the face of the earth in such a way that each region has some measure of productive superiority.

Conditions other than those of a purely climatic or geographic nature, however, may give one region an advantage over another in the production of the needed things of life. The culture, traditions, and training of a people, although constantly changing, are nevertheless important at any particular time. The Chinese and, to a large extent still, the Japanese are skilled in the handicraft arts, while in the United States, Germany, and Great Britain a machine culture has been developed to a high degree of perfection. Silk production does not seem amenable to machine methods, while wool and cotton textile goods are made by very highly developed machine techniques. The Orient, therefore, enjoys an advantage in silk production, and Western peoples, in those things that are suitable to machine manufacture.

So long as people direct their energies to those things which they can produce to advantage, they are able to gain the maximum amount of wealth with the minimum expenditure

Brazil Ships Big Cocoa Cargo.

Special Cable to THE NEW YORK TIMES.

RIO DE JANEIRO, March 30.—Sixty thousand bags of cocoa, said to be the largest shipment ever sent out from Brazil, has left Bahia for New York on the S. S. Pocone.

CASE 91

EMPIRE GRAIN TO BRITISH.

Marked Rise in Wheat Imports for Twelve Months.

OTTAWA, May 23 (AP).—Imports of wheat into the United Kingdom from empire countries showed a marked increase during the last twelve months, as compared with the corresponding period a year ago, according to figures just released by the Department of Trade and Commerce. Imports from the United States showed a sharp drop.

CASE 92

Drop In Cuban Sugar Output.

At the official termination of the year's grinding on July 15, Cuba had produced 1,994,663 long tons of raw sugar, according to Lamborn & Co. This is a drop of 23 per cent from the 2,602,864 tons produced in the preceding year, and the smallest total since 1912. In 1929 Cuba's production totaled about 18 per cent of the world total, while this year it was about 8 per cent.

CASE 94

SOVIET FUR AUCTION GREATEST EVER HELD

Sales Are Expected to Exceed 5,000,000 Rubles—Dressing and Dyeing Show Gains.

Special Cable to THE NEW YORK TIMES.

LENINGRAD, Aug. 6.—The four-day fur auction opening here today will be the greatest in Soviet history, with seventy foreign firms represented by 150 buyers. Motty Eitingon of the New York firm Eitingon-Schild Fur Company, Inc., who has a big contract with the Soviet Government, including a monopoly of sables, told your correspondent he expected sales to reach the record figure of 5,000,000 rubles, with prices firm. He added that the Russians had made great strides in the new industry of dressing and dyeing furs, which formerly was left to foreigners abroad.

CASE 95

Silk Imports to Rise.

SAN FRANCISCO, Feb. 12 (AP).—Large shipments of raw silk will arrive in Pacific Coast ports this month, and, although the silk industry is struggling to retain its former prosperity, authorities today generally agreed that imports would exceed those of last February, with some twenty-eight carriers arriving from Japan.

CASE 93

The New York Times.

of effort. All that is accumulated over and above local needs may be exchanged with other peoples pursuing a like policy. Thus all are able to enjoy a wide variety of products and the maximum bulk at the least cost.

The situation is, however, seldom so simple. It often happens that one nation may profitably import a product from another despite the fact that the importing nation enjoys an advantage in the production of that particular commodity. Most of the hemp used in this country is imported from Italy. However, it is possible to produce hemp here, perhaps to even better advantage than it can be produced elsewhere. But when the advantage obtained in the production of hemp in the United States is compared with the advantage obtained in the production of other things, it is found to be relatively small. Therefore, it pays better to produce those other things and to import hemp. In such a case, there is said to exist for the United States an *absolute advantage* in the production of hemp, but a *comparative advantage* in the production of other things.

Indeed, this principle of comparative advantage is practiced in our everyday lives. A lawyer may actually be a better typist than his secretary, but it is more profitable for him to practice law. Likewise, an executive may be able to keep his accounting records better than his bookkeeper, but it pays him better to devote his energies to the general management of his business. When seen in this light, the principle of comparative advantage seems quite self-evident. It is, in fact, almost axiomatic.

1. Refer to Cases 91, 92, 93, 94, and 95. What is indicated in these news items in reference to comparative advantage?

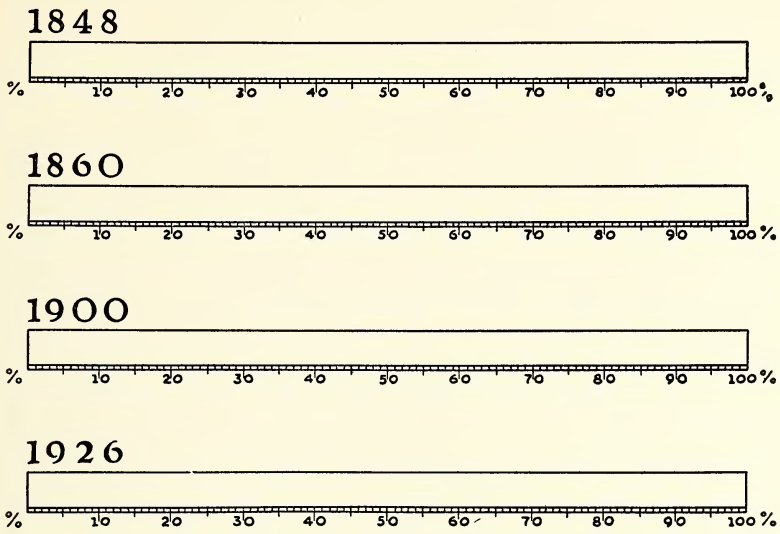
2. Using the table appearing on page 270, suggest a number of commodities that nations might exchange in accordance with the principle of comparative advantage.

3. Using the figures given in the table on page 271, construct a chart like that in the sketch shown on the same page. Consider the total trade in 1926 as 100%. Plot, accordingly, the total trade for 1900, 1860, and 1848 in the other bars. For convenience in plotting, the total foreign trade for each year is given as a percentage of the total trade for 1926. Divide each bar into two parts by plotting the total foreign trade for each year in the left-hand part of the bars.

COMPARATIVE ADVANTAGE IN THE VARIOUS COUNTRIES

Countries	*Production Possible and Desirable* (Country enjoys a comparative advantage.)	*Production Possible but Less Desirable* (Country has lack of comparative advantage.)	*Production Difficult or Impossible* (Country suffers a decided disadvantage.)
United States	Manufactured products Petroleum products Cotton Corn Coal Copper Lead Wheat Tobacco	Coarse wool Flax Fish Hides and skins	Silk Cane sugar Coffee Manganese Platinum Rubber Tin Nickel Asbestos Cocoa
Cuba	Iron ore Cane sugar Tobacco	Coffee Cocoa	Coal Manufactured products Rice Pork
Brazil	Maté Coffee Cocoa	Meat products Rubber Cotton	Manufactured products Wheat Coal
U.S.S.R. (Russia)	Wheat Lumber Petroleum products Manganese Platinum Furs Flax	Manufactured products Coal and iron Fish Copper Cotton	Lead Zinc Rice Tea
Argentina	Beef Wheat Wool Corn Linseed	Dairy products Pork	Iron Coal Lumber Petroleum products Manufactured products
Japan	Fish Silk Pottery	Copper Rice Coal Petroleum products	Rubber Cotton Wheat Iron

Color the right-hand part of the bars one color and the left-hand part another color. In this way our foreign trade, shown in the left-hand sections, can be seen in proportion to our total trade, shown by the entire colored sections. Entitle the chart "U. S. Total and Foreign Trade, 1848–1926."



Year	*Total Trade* (Corrected According to 1926 Value of the Dollar) (Millions of Dollars)	*Per Cent of 1926 Total Trade*	*Total Foreign Trade* (Corrected According to 1926 Value of the Dollar) (Millions of Dollars)	*Per Cent of 1926 Total Trade*
1848.....	3,000	5.6	530	0.5
1860.....	3,500	5.7	1,100	1.0
1900.....	20,000	35.5	4,000	4.0
1926.....	100,000	100.0	9,143	9.0

4. Does this completed chart make it appear that our foreign trade is very important?

5. By reference to the following quotation, show why American foreign trade is important despite the fact that its volume is small compared with the domestic trade.

> "For any one of the competitors, operation at 60% or 70% of capacity is necessary if expenses are to be met and dividends paid. Anything less than that amount of business means loss, perhaps failure. More than that means a large increase in net gain. . . . This has important results in the field of foreign trade." [1]

[1] Patterson, Ernest Minor, *The World's Economic Dilemma,* p. 78.

6. Refer to Cases 96 and 97. (a) From the standpoint of comparative advantage and the importance of foreign trade to the United States, discuss the relative merits of these viewpoints. (b) With respect to these two contending policies—economic nationalism or world trade—is the United States in any different position from that of most other countries?

DECLARES NATION CAN THRIVE ALONE

Anthracite Institute Head Says We Can Prosper Without Rest of the World.

A SELF-CONTAINED UNIT

Government Waste Has Paralyzed Trade, B. P. Disque Tells 1,000 Coal Operators.

The doctrine that the United States can be prosperous regardless of what the remainder of the world is doing was laid down last night by Brice P. Disque, newly elected president of the Anthracite Institute, addressing more than 1,000 hard-coal operators, dealers and exporters at the annual dinner of the New York Anthracite Club.

The United States, with more than 90 per cent of its total production consumed at home, is a self-contained social and industrial unit, Mr. Disque said, and the sooner Americans recognize the significance of that fact the sooner will they all go to work.

"If America is dependent upon world conditions the future is dark," he said, "but I have a distinctly different view, and I am optimistic about the possibilities of the immediate future.

"Industry and commerce are being paralyzed by excessive govern-

CASE 96

ASSAIL BARRIERS TO WORLD TRADE

Experts, Back From Economic Parley, Warn of Policy of a Self-Contained Nation.

SEE RECOVERY BLOCKED

Lower Tariffs and Stable Currency Are Necessary for Advance, the American Delegates Hold.

The so-called "buy-American" idea was criticized yesterday by Professors Edmund E. Day and John H. Williams, United States delegates to the preparatory commission of experts for the international Monetary and Economic Conference, who returned on the United States liner Leviathan.

Aided by Frederick Livesey, assistant economic adviser of the Department of State at Washington, who returned with them, the two delegates outlined the results of the commission's conferences, which were announced in Geneva before they departed.

On the question of the "buy-American" movement, Professor Williams said he regarded such an idea as dangerous and contrary to the accepted belief of dependence among nations.

"If you carry the 'buy-American'

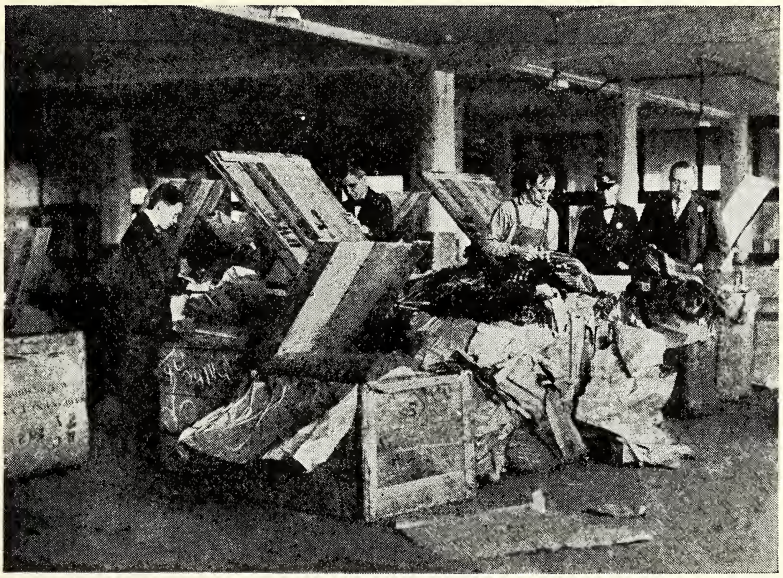
CASE 97

The New York Times.

UNIT 2.—A PROTECTIVE TARIFF

Observations and Discussions.

A *protective tariff* is a tax applied on imported commodities. It is sometimes applied at a flat rate of so much an article, pound, bushel, or whatever the unit may be, or it may be applied as a percentage of the value of an article. If the latter, it is called an *ad valorem* (according to the value) duty or tax.



United States Custom House Officials Examining Imported Commodities.

In the United States, tariffs were first applied chiefly for revenue purposes, and for many years this tax was the most important source of income for the Federal government. Its importance as a revenue producer, however, has through the course of years given way to its importance as a means of "protecting" home industries. The extent of the protection may go so far as to impose a tax so high that the foreign article is excluded altogether. In that event the domestic producer or producers, of course, have the entire home mar-

ket to themselves. But even if, despite the tax, the article continues to be imported, the amount of the tax is in most cases added to the price and paid by the ultimate consumer. This enables the domestic producer to obtain a higher price for his product than otherwise would be possible. Then, although his costs may be higher than those of his foreign competitor, he can compete successfully and is therefore protected to the extent of being able to engage in an enterprise that, except for the tax, would be unprofitable.

The question of the relative merit of protection, on the one hand, and *free trade,* or the absence of all protective tariffs, on the other, was for many years the chief source of contention between the two leading political parties in the United States. Today it is an important consideration in the controversy between the isolationists, those who would make of the United States a self-sufficient nation, and the internationalists, those who believe that our welfare depends upon the development of trade relationships with foreign lands.

There are sound arguments for both free trade and protection.

1. Those who advocate free trade assert that it assures the maximum amount of the comforts and luxuries of life for all people in all parts of the world. Develop an argument to support this conclusion.

> **Think:** The measure of comforts and luxuries of life that a people enjoy depends fundamentally upon the quantity of these things that they create by virtue of their labors. If they work in accordance with the principle of comparative advantage, what will be the result? If they work contrary to this principle, what will be the result?

2. However sound this basic argument for free trade may be, the establishment of free trade, where protection now exists, would entail huge losses. Where, for example, would such losses be sustained?

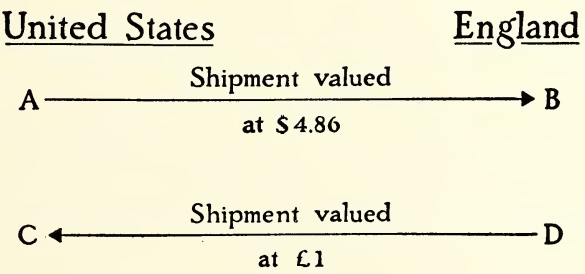
3. Frame an argument for protective tariffs, based on the following quotation:

"It is a just observation that minds of the strongest and most active powers for their proper objects fall below mediocrity, and labor without effect if confined to uncongenial pursuits. And it is thence to be inferred that the results of human exertion may be immensely increased by diversifying its objects. When all the different kinds of industry obtain in a community, each individual can find his proper element, and can call into activity the whole vigor of his nature. And the community is benefited by the services of its respective members in the manner in which each can serve it with most effect.[2]

4. It has been explained that an import tax on a foreign article may enable a domestic producer to obtain a higher price for his product to offset higher costs and thus to engage in an enterprise that, except for the tax, would be unprofitable. How might this be of advantage to the nation in the event of a newly formed enterprise operating quite in accordance with the principle of comparative advantage, but unable to compete with old and well-established concerns abroad because of lack of experience?

5. If a country is contemplating war, why is a protective tariff beneficial?

In considering the effects of a protective tariff, we must keep in mind that a nation's imports are paid for not by money, but by the nation's exports. For example:



6. Copy the accompanying diagram in your notebook. *A* in the United States ships *B* in England material valued at $4.86. At the same time, *D* in England ships to *C* in the United States material valued at £1. If £1 = $4.86, how may both transactions be settled without the shipment of any money from one country to another?

Temporarily, of course, the value of a nation's exports may exceed the value of its imports, or the value of its imports may exceed the value of its exports. In either case, the dif-

[2] Alexander Hamilton, Report on Manufactures, 1791.

ference is called the *balance of trade*. The balance of trade is called *favorable* or *active* when the exports exceed the imports, and *unfavorable* or *passive* when the reverse occurs. The terms "favorable" and "unfavorable" should not be interpreted as meaning "desirable" and "undesirable," respectively. At one time a favorable balance of trade was thought always to be desirable and an unfavorable balance of trade necessarily undesirable. The terms have persisted in use to this day although our ideas have changed.

A long-continued unfavorable balance of trade might lead to a shipment of gold, or a persistent favorable balance might lead to the importation of gold. Gold thus circulates among nations, settling trade balances here and there. It is a sort of international currency because it can easily be made into the coins of any particular country. Obviously, however, a nation could not forever have an unfavorable balance of trade, because it would lose all of its gold and could not pay for its imports; likewise a country could not forever have a favorable balance of trade, because it would receive all the gold in the world and then could not collect for its exports. Temporarily a nation's trade may be favorable or unfavorable; eventually it must balance, the value of its exports equaling the value of its imports.

7. It is sometimes said that a protective tariff creates employment. Keeping in mind the ultimate relation that must exist between a country's exports and imports, show that the employment argument is fallacious.

> **Think:** If, by means of a protective tariff, foreign goods are kept out of the country and the demand for those goods is supplied by a domestic manufacturer, employment has, of course, been created in that particular factory. But the imports have been reduced; therefore, what must happen eventually to the exports? How will this affect those employed in the enterprises engaged in the export trade?

8. It is sometimes said that a protective tariff on manufactured articles creates a market for agricultural products. Refute this argument on the grounds suggested above.

Executive Power to Revise Tariffs as Aid In Restoration of Foreign Trade

The President's Request for Authority to Bargain With Nations for Sales Abroad

Never had an American President asked of Congress what President Roosevelt asked March 2. He requested power to become sole judge of tariff rates for a period of three years, with authority to raise or lower by 50 per cent the duties that now protect American markets.

His purpose was to become a Yankee trader. He would send his emissaries out into the markets of the world to bargain for the trade that now is being parcelled out in a new type of economic warfare. After years of buffeting, the United States would be armed with the weapons already in use by other nations.

It all is part of the program of the President to regain for this country some of its lost markets, to open the way for sale abroad of more farm products and to ease the adjustments that he claims will be necessary unless foreign trade again is revived.

CASE 100

United States News.

DAVIS ATTACKS TARIFF MEASURE

Would Forbid Reciprocal Pacts on Articles Produced at Higher Costs in U. S.

From THE WALL STREET JOURNAL *Washington Bureau*

WASHINGTON—The reciprocal trade tariff bill was assailed by Senator Davis (Rep., Pa.) when consideration of the measure was resumed in the Senate.

Senator Davis proposed an amendment which would forbid entry into an agreement by the United States with a foreign nation respecting an article which is produced cheaper abroad than a similar article could be made in the United States. With this amendment, Davis contended, purchasing power at home would be stimulated and maintained and employment benefited.

Editorial Opinion Strongly Backs Tariff Measure

Sentiment on the reciprocity tariff bill, giving the President power to negotiate with foreign countries, is divided in these proportions, as exhibited in the press of the country: For the measure, 72 per cent; against, 28 per cent. Among the indorsements is the statement that we may have "the ability to swap our way back into a fair share of the world's trade." Among the adverse comments is the argument that there will be "an added worry to industry's already generous store of nervousness and uncertainty."

CASE 99

Wall Street Journal.

CASE 98

United States News.

9. (a) Is it true that throughout a country a protective tariff raises wages and keeps them high? (b) May this be true in a particular industry?

> **Think:** The more economic goods created, the more there are to divide. Other things being equal, labor will produce more when devoted to industries that are best adapted to the existing geographic and climatic conditions and aptitudes of the people. When a protective tariff creates an industry not so adapted, the labor devoted to it is proportionately less effective; there are consequently less economic goods created and less to divide. Do high wages, then, depend upon protective tariffs?

10. Refer to Case 98. Why, under the conditions cited, would there be an added worry to industry?

11. Refer to Case 99. Evaluate the suggestion that no agreements with foreign powers be consummated respecting an article which is produced cheaper abroad than a similar article could be made in the United States.

> **Think:** If such articles were allowed to enter the United States duty free, what immediate financial losses might be sustained? What immediate effects in the matter of employment might be expected? According to the principle of ultimate balance between the value of a country's imports and exports, is it possible that compensations for such losses might eventually develop? According to the principle of comparative advantage, what might you reply to the Senator's argument?

12. Refer to Case 100. How in this way might the adjustments contingent upon the revival of foreign trade be eased?

> **Think:** Would it be possible, for example, to select for the bargaining process certain articles for import which would occasion the least damage, while selecting the articles for export that would bring the greatest benefit?

13. Summarize in your notebook: (1) basic arguments against a protective tariff, (2) sound arguments for a protective tariff, and (3) fallacious arguments for a protective tariff.

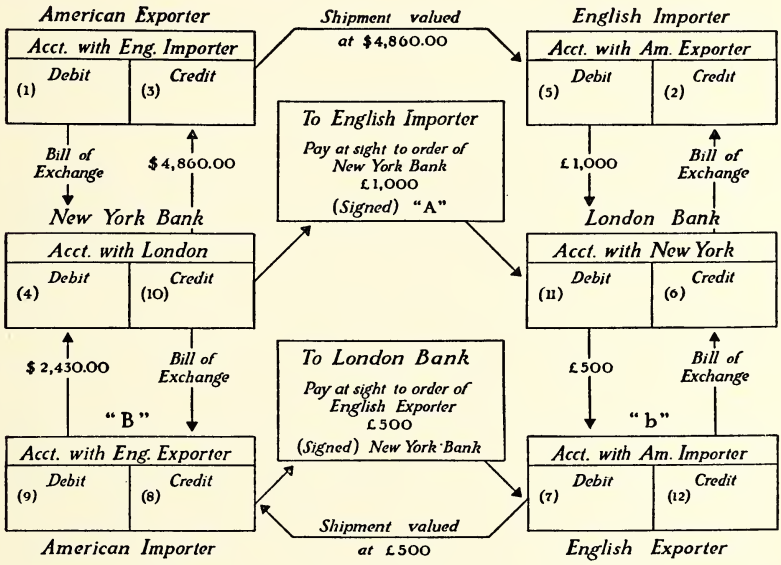
UNIT 3.—INTERNATIONAL EXCHANGE

Observations and Discussions.

1. Refer to page 275, question 6. Taking into consideration the fact that there are hundreds of merchants in the United States shipping materials to as many merchants in England, and that still other hundreds of English merchants are constantly shipping things to their customers in the United States, why would the method suggested in your answer to the above question prove awkward?

2. Appoint a committee of seven to conduct a demonstration before the club showing how international payments are made.

On the day of the demonstration place the following diagram on the blackboard:



In your notebook copy the chart placed on the board. Fill in the spaces as the demonstration proceeds, and at the same time make a list of the transactions that occur, such as: (1) the American exporter ships to the English importer materials valued at $4,860.00; (2) the American exporter sells a bill of exchange to the American banker; (3) the bill of exchange is sent to the English bank, etc.

Have ready two books of different colors to represent mer-

chandise; two pieces of colored paper to represent English money, one marked £1,000, and the other, £500; two pieces of white paper to represent United States money, one marked $4,860, the other, $2,430; and two forms of bills of exchange such as those shown in the sketch.

One member of the committee may stand at the blackboard and record the various transactions; the other members of the committee may be assigned to act as: an American importer, an American exporter, an American banker, an English importer, an English exporter, and an English banker.

The demonstration is carried out as follows: one of the books is passed from the American exporter to the English importer. This represents a shipment of merchandise amounting to $4,860.00. A charge for this amount is entered in the books of the American exporter (space one). At mint par of exchange, according to the 1900 standard, $4,860.00 equals £1,000. The English importer, therefore, credits the American exporter with £1,000 (space two).

The American exporter wishes to be paid for this shipment. He therefore issues a *bill of exchange* such as the one shown in the upper middle part of the sketch. He then goes to the American bank and sells this document to the bank. For the present, we shall consider that he sells it at the mint par of exchange mentioned above. What actually governs the price at which a bill of exchange is sold, we shall see later. Having sold the bill of exchange and having received for it $4,860.00 less the bank's commission, the American exporter credits this sum to the English importer (space three).

The American bank now indorses the bill of exchange and forwards it to the English bank, at the same time charging the English bank $4,860.00 (space four). The English bank presents the bill to the English importer and receives for it English currency to the amount of £1,000. This settles the transaction for the English importer. He therefore charges £1,000 to the American exporter (space five), while the English bank credits the same amount to its American correspondent (space six).

An English exporter now ships merchandise to an American

importer. The transaction amounts to £500. A charge is set up on the books of the English exporter for this amount (space seven), and $2,430.00 is credited on the ledger of the American importer (space eight). The American importer wishes to settle his bill. He therefore buys from the American bank a bill of exchange such as the one shown in the lower middle part of the sketch. For this he pays, let us say, $2,430.00. This settles the account so far as the American importer is concerned. He therefore charges the English merchant $2,430.00 (space nine). The American bank, having received the cash, credits its English correspondent bank with $2,430.00 (space ten).

The bill of exchange is now mailed to the English exporter who presents it to the English bank and receives for it £500. The English bank charges this £500 to its American correspondent (space eleven). The transaction being settled for the English exporter, £500 is credited to his customer in America (space twelve).

3. According to the above demonstration, how do banks solve the difficulty raised in your answer to question 1?

4. At the end of the demonstration, what was the financial relationship between the two banks?

Bills of exchange are seldom if ever bought or sold at the exact mint par of exchange. Bankers desire to keep their balances abroad at fairly constant levels. If in New York the demand for English bills of exchange is greater than the supply, the New York banks will be receiving dollars and the London banks will be paying out pounds. This will deplete the foreign balances of the New York banks. In consequence, the price of London bills of exchange will advance somewhat above the mint par of exchange. This will discourage the buying and encourage the selling of London bills of exchange and thus bring the foreign balances back to normal. Conversely, if the supply of London bills of exchange exceeds the demand, balances in the English banks will grow. Bankers in New York will then sell London bills of exchange a bit below the mint part of exchange. This will increase the buying and

decrease the selling of London bills of exchange and help to balance the accounts.

5. Considering your answer to question 4, would this financial relationship tend to advance or decrease the price of London bills of exchange?

There is, therefore, a market price for bills of exchange. This market price is called the *exchange rate.* When two countries are on the gold standard, however, the fluctuations of the rate of exchange about the mint par of exchange are definitely limited. You will recall that according to the gold standard all kinds of money are freely exchangeable for gold. No foreign creditor wants American money, but gold that can always be cast into foreign coins or exchanged for other kinds of foreign currency is always acceptable. Instead of buying a bill of exchange to settle a foreign debt, therefore, there is always the alternative of shipping gold, if that is obtainable. To be sure, it is usually cheaper to buy a bill of exchange, but if the price goes up beyond the cost of shipping gold, then gold can and will be shipped. If it costs, say, three cents per pound sterling to ship gold from New York to London and the mint par of exchange is £1 = $4.86, then English bills of exchange will never cost more than $4.89 per pound, because if the American importer is asked to pay more than this, he can save by exchanging his American money for gold and shipping the gold. Nor will London bills of exchange ever sell at less than $4.83, because the American exporter has always the option of importing the gold at a cost of $.03 per pound. These rates of exchange at which gold will be exported or imported are called the *gold points.*

When countries are on the gold standard, then, gold acts as a final means of settlement. Exchange rates will fluctuate as imports exceed the exports or as the exports exceed the imports, but a long-continued excess of either will cause gold to be shipped.

When countries are not on the gold standard, the alternative of shipping gold is absent. Bills of exchange must be bought and sold, and there is no limit to the fluctuations that may

BEARS RUSH TO BUY DOLLARS IN EUROPE

Stampede of Speculators in London Causes Advances and Closing Is at 3:39.

Wireless to THE NEW YORK TIMES.

LONDON, March 13.—Faith in the dollar was rewarded today when American exchange opened higher than a week ago and gathered strength throughout the afternoon.

To the immense relief of the financial community the first quotation was 3.44 to the pound—nearly a cent better than before the banking difficulties burst upon the United States. There were some fluctuations in the excited dealings that followed, but in the scramble to buy the dollar advanced hourly until it closed at 3.39.

Speculators stampeded to unload sterling and buy back the dollars they had sold in panic last week. Undoubtedly some of the dollar's strength today was attributable to this source, although there could be no mistaking the general feeling of confidence in President Roosevelt's leadership and in the prospect of recovery by the United States.

CASE 101

$400 Sent to Austria in 1916 Is Now Found Worth 4½ Cents

Special to THE NEW YORK TIMES.

CHICAGO, March 19.—Mrs. Chane Stiefel, a 70-year-old native of Vienna, came to Chicago with her family in 1910.

They gradually accumulated a modest savings account, and when $400 had been laid away Mrs. Stiefel became distrustful of American banks. The whole sum was sent to the Postal Savings Bank in Vienna and recorded there on May 15, 1916, in the form of 3,100 kronen.

Recently, in an effort to recover the deposit, a letter was sent to Ernest L. Harris, American Consul in Vienna, for Mrs. Stiefel had now become a naturalized American.

His reply, received today, read as follows:

"The Consulate General has to inform you that due to the depreciation of the Austrian kronen currency to 1-14,440 of its pre-war gold value, the 3,100 kronen of Mrs. Stiefel now represents the equivalent of .31 groschen, or 4½ cents if converted into United States currency.

"This is not sufficient to cover the postage for an ordinary letter to the United States from Austria."

CASE 103

Importers Curb Activities To Meet Currency Drop

Sharp declines in the value of the dollar in international exchange in the last few weeks will force scores of importers to discontinue the handling of foreign merchandise, according to statements made here last week by leaders in the trade. The fall of the dollar, it was explained, has hit all importers, but is bearing with greatest weight upon those who deal in goods ordinarily sold in fixed-price ranges. In many cases import jobbers have suspended all import activities and are handling lines of domestic-made goods. They do not plan to trade in foreign merchandise again until the dollar is stabilized.

Costs of handling imported products have advanced at least one-third since the dollar fell, it was pointed out.

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CASE 102

The New York Times.

take place. The laws of supply and demand operate without restraint.

6. Refer to Case 101. The news report says that the "first quotation was $3.44 to the pound . . . but in the scramble to buy, the dollar *advanced* hourly until it closed at $3.39." Explain.

> **Think:** Speculators were offering pounds and buying bills of exchange payable in New York in terms of dollars. At the opening, £1 bought a claim of $3.44 in New York. As the day advanced, did the demand for dollar exchange increase or decrease? How did this affect the price in pounds of the dollar bills of exchange? At the end of the day if a speculator wanted to buy a bill of exchange amounting to $3.44, did he have to put up more pounds or fewer pounds than at the opening? Or, putting the same situation in another way, for £1 could he buy more dollars or fewer dollars?

7. Refer to Case 102. Why will sharp declines in the value of the dollar in international exchange discourage American imports?

> **Think:** Will the importers have to put up more or fewer dollars to buy bills of exchange in payment for the materials imported? How will this affect the prices at which they will have to sell? How will this probably affect their sales?

8. On the other hand, how will a depreciated currency affect exports? Explain.

9. (a) How would the announcement of the United States' going off the gold standard affect the price of dollar bills of exchange abroad? (b) How would a large issue of fiat money in the United States affect the price of dollar bills of exchange abroad? Explain.

10. Refer to Case 103 and explain what circumstances might bring about a situation such as this.

The rate of exchange is influenced, of course, by the balance of trade, but it is also influenced by other factors which bring about a demand for and a supply of bills of exchange. Some of these other factors are: investments abroad, the purchase of foreign securities, payments of interest and dividends to foreigners, transportation expenses and insurance premiums paid to foreign corporations, tourist expenses, and immigrant

remittances to relatives in the homeland. These are called the *invisible items* of trade.

11. How will the dollar rate of exchange be affected by the following: American investments abroad; interest and dividend payments by foreign corporations to Americans; American tourists traveling abroad; Americans buying insurance from foreign companies; Americans shipping goods or traveling on foreign ships?

> **Think:** In each case, is a bill of exchange bought or sold? How is the demand and supply of bills of exchange affected thereby? What is the effect on the price of bills of exchange and hence the exchange rate?

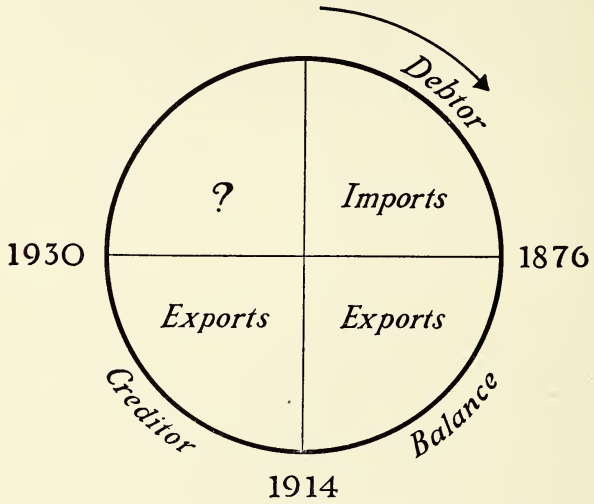
Such transactions not only influence the rate of exchange but are important in explaining a nation's balance of trade. Thus, over long periods of time, commodity imports may exceed commodity exports if during the same period the importing country is receiving loans from abroad. Capital is literally being borrowed. Likewise, exports may exceed imports so far as commodities are concerned if at the same time the exporting country is granting loans abroad. In that case, capital is being loaned. In each case, when the loans are repaid, the balance of trade is reversed.

Until about 1876 the imports of the United States exceeded its exports. During the same period, the United States was becoming more and more a debtor nation. Foreigners were investing here, which meant that bank balances were being equalized by the purchase of dollar exchange abroad not altogether for the payment of goods shipped from this country, but for investments being made in this country.

From 1876 until approximately 1930, our exports exceeded our imports. During part of this period, say until 1914, our excess exports were paying back the borrowed capital and the interest on this capital. Bank balances, then, were being equalized by the purchase here of foreign exchange not only for goods received, but for interest payments and for capital repayments.

After 1914 our exports continued to exceed our imports, but

for another reason. We were then becoming a creditor nation. Foreign exchange was being purchased here not only for goods received, but for loans being made abroad.



These three periods have been set forth graphically in the accompanying sketch. The fourth period has been indicated by an interrogation mark.

12. Refer to Case 104 (page 288). In the light of the above discussion, explain why in this fourth period the United States must either cut its tariff or its exports.

Draw a diagram in your notebook as follows:

UNITED STATES	EUROPE
Merchants	*Merchants*
Federal Reserve Banks acting as fiscal agent of the government	*Central banks acting as fiscal agents of governments*
General Public	*General Public*

In order to finance the World War, Liberty Bonds were sold to the American public for which funds in the form of cash or credit were received by the United States government. Place an arrow starting with the Federal Reserve Bank to the general public and mark this arrow "bonds." Draw another arrow running in the opposite direction and mark it "funds." Part of these funds were loaned to foreign nations; that is, certain funds were placed to the credit of these foreign nations against which charges might be made for material purchased in the United States.

Merchants in the United States sold war materials abroad and collected for these by selling bills of exchange to the Federal Reserve Bank acting as fiscal agent of the United States government. These bills were then charged against the loans made by the foreign governments. Draw an arrow from the United States to Europe and mark this "war materials." Draw an arrow from the United States merchants to the Federal Reserve Bank and mark this "bills of exchange." Draw another arrow in the opposite direction and mark this "funds."

13. (a) What was really loaned to Europe? (b) Where did the funds go that were used to buy Liberty Bonds?

Using the same chart but another color ink, plot arrows as follows, showing how these war debts might be paid. On the Europe side of the chart, plot an arrow from the public to the central banks and mark this arrow "taxes." Draw an arrow in the opposite direction and mark it "services and materials used in the war."

Draw an arrow from the merchants in Europe to the merchants in the United States and mark this "goods and services." On the United States side of the chart, draw an arrow from the merchants to the Federal Reserve Bank and mark this arrow "funds." Draw an arrow in the opposite direction and mark it "bills of exchange." Draw an arrow from the United States merchants to the European merchants and mark this arrow "bills of exchange." Draw an arrow from the European merchants to the central banks and mark it

NATION MUST CUT TARIFF OR OUTPUT, WALLACE ASSERTS

America Is Urged to Fix on Nationalism or Internationalism or a Compromise.

AND STICK TO IT 10 YEARS

Long-Time Planning Essential, Whatever the Choice, He Tells Muncie Audience.

By The Associated Press.

MUNCIE, Ind., Nov. 14.—Secretary Wallace tonight asked that America take a position for reducing tariffs or curbing production, or decide on a compromise between the two, and be prepared to stick to its decision for ten to fifteen years.

"The important thing," the Secretary of Agriculture said in the third and last speech of his swing through the Midwest in behalf of the administration's program, "once we have fully debated and understood the issues from a long-time point of view, is that we follow out the policy streadfastly and firmly in all its implications, even though certain people are hurt.

"If we follow the international program, we absolutely must receive great quantities of goods from abroad and must not be disturbed by the clamor of people who are hurt thereby. If we follow the national program, we must resolutely plan to keep 50,000,000 acres of land out of use, no matter how loud may be the outcry of certain carrying, handling, processing and exporting interests.

SHIFT ON TARIFF URGED BY WALLACE

We Must Begin to Import More Than We Export or Lose Debts, He Says.

AND ALSO FARM OUTLET

Tariff Barriers Can Be Eased Without Crippling Domestic Industry, He Holds.

Special to THE NEW YORK TIMES.

WASHINGTON, Nov. 23. — The United States must either reverse its present commercial policy and begin to import much more than it exports, or be prepared to forego collection of debts owed to it by foreign countries, Secretary Wallace said today.

This was clear, he said, from the creditor position of the United States with respect to foreign countries and the fact that about $1,000,000,000 a year is required by foreign countries to service their indebtedness to us and maintain a purchasing power sufficient to buy America's surplus farm products.

The Secretary of Agriculture made it clear that this was his own personal opinion but held it to be obvious that the indebtedness of foreign governments and nationals could only be paid in goods and services. For the latter reason, he argued, the United States must now become a net importer rather than an exporter of far more than it was willing to receive from foreign countries in return.

CASE 105

CASE 104

The New York Times.

"bills of exchange." Draw an arrow in the opposite direction and mark it "funds."

Draw an arrow from the Federal Reserve Bank to the American public and mark it "funds," and in the opposite direction draw an arrow and mark it "paid bonds."

14. (a) According to the above explanation the burden of paying the debts falls ultimately upon whom? (b) What is actually returned to the United States?

15. Using the same chart, draw a line at right angles to the "goods and services" arrow reaching from the European merchants to the United States merchants, and mark this arrow "U.S. tariff," indicating that goods will not be admitted. This blocks off the logical method of paying the debts. (a) What is the only method left? (b) It is estimated that in 1931 there was $6,669,000,000 of monetary gold in France, England, Germany, Russia, and forty other countries. At about the same time the war debts amounted to $7,390,000,000; what light does this throw on the other way of settling the war debts? (c) What effect would a large concentration of gold in one country have upon international trade?

16. Refer to Case 105. Why must the United States either reverse its present commercial policy and begin to import much more than it exports, or be prepared to forego collection of debts owed to it by foreign countries?

Conclusions.

A. Why is international trade of advantage?
   1. What is meant by absolute advantage?
   2. What is meant by comparative advantage?
   3. How does the volume of our foreign trade compare with the volume of our domestic trade?
      (a) Does this reveal the relative importance of our foreign trade? Explain.

B. What is a protective tariff?
   1. Show how protection may take place.
   2. What is the basic argument for free trade?
   3. Outline three sound economic arguments for adopting a protective tariff.
   4. What is meant by "balance of trade," "favorable balance," "unfavorable balance"?
      (a) What relationship must eventually exist between a nation's exports and imports?
         (1) What part does gold play in international trade?

5. Explain three common but fallacious arguments supporting protective tariffs, and having to do with:
   (a) Employment.
   (b) Markets.
   (c) Wages.

C. Explain how international payments are made.

1. How is the exchange rate governed?
   (a) What difference does it make in the matter of international exchange whether or not a nation is on the gold standard?
2. Name some invisible items of trade.
   (a) How may these affect the exchange rate?
   (b) Explain how they may delay an eventual balance between a nation's exports and imports.
3. Outline the changes that have taken place in the foreign trade policy of the United States.
   (a) What conflict exists in the matter of the present trade policy and international debts?

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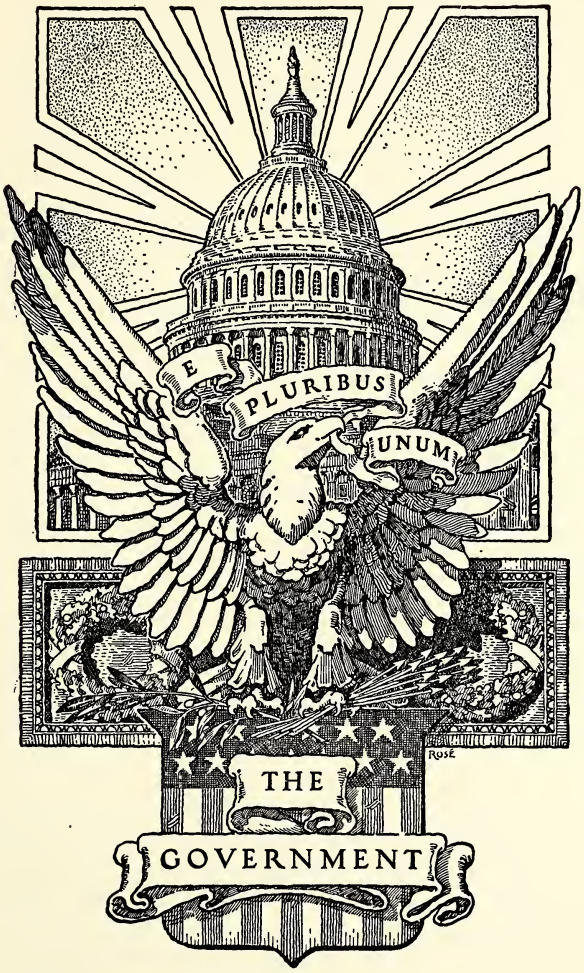
CHAPTER XVI



CHAPTER XVI

The Government

UNIT 1.—THE GOVERNMENT IN BUSINESS

Observations and Discussions.

1. Refer to the chart, "Fundamental Relationships in Economic Life," on page xii in the front of the book. The economic life of a society may be based upon principles of varying degrees of governmental control. (a) In which system does the State exercise the least control? (b) In which system does the State exercise the greatest control? (c) Where does capitalism stand?

Review what was said on pages 233–234 about Adam Smith's philosophy of the so-called "invisible hand" and its influence upon American economic life.

2. If it is true that the best possible conditions for society as a whole are attained when each individual works to his own self-interest, then what policy should the government follow in its relationship with economic life?

The term *laissez-faire,* meaning "leave alone," is used to characterize this policy.

3. Refer to pages 238–240. Mention instances in which the policy of laissez-faire apparently has failed to promote the best interests of society as a whole.

> **Think:** Note Case 80, on page 234; what conflict is sometimes apparent between the interests of individuals and the interests of society? Note question 6 on page 238; how about good homes for the masses of people? Note question 7 on page 238; how has the farmer fared? Note question 10 on page 239; does this allow the lower income groups to buy the good things of life? Note question 11 on page 240; how will this affect future generations?

4. Refer to Case 106 (page 294). Has the government intervened to an increasing extent in economic activity?

Think: Consider protective tariffs, pages 273–274. Consider the Sherman and Clayton Acts, the Interstate Commerce Commission, the Federal Trade Commission, and the various state public utility commissions, pages 259–263. Consider the history of banking in the United States, pages 135–138.

The occasion that gave rise to the resolution quoted in Case 106 was the government's greatly increased activities in almost every branch of economic life starting in 1933. At that time the country was in the depths of a period of depression. In a supreme effort to check the depression and start industry and trade on the road to recovery, the government embarked upon a broad economic program.

World Chamber Opposes 'Too Much Government'

Warns Against 'Exaggerated Measures of Restriction'

PARIS, June 29 (AP).—A warning against "too much governmental interference in business" was issued today by the International Chamber of Commerce in a statement which mentioned neither the N. R. A. of the United States nor the planned economies of other nations.

The statement was based on a resolution adopted by the council of the chamber.

"While the council realizes governments are obliged to intervene to an increasing extent in economic activity, it urges that governments recognize fully the great value of voluntary cooperation, the effective functioning of which should not be destroyed by exaggerated measures of restriction and control," the statement said. "In no case should the principle of self-help among business interests themselves be prejudiced."

CASE 106 *New York Herald Tribune.*

In the case of certain key agricultural products, such as wheat, cotton, and tobacco, farmers were given the opportunity to reduce the acreage planted in these crops and were paid rent for the land thus put out of use. The money paid to the farmers was collected by means of what was termed a *processing tax.* Those who first bought the wheat, cotton, tobacco, and so forth, from the farmer were subjected to a tax of a stipulated amount per bushel or per pound, as the case might be. These first processors were expected to add the amount of the tax to their prices and thus pass on the burden to the ultimate consumer. It was expected that the decreased supply of agricultural products would eventually so operate

as to bring the prices of agricultural products and the prices of manufactured products nearer parity. This increased purchasing power in the hands of the farmers would, it was argued, improve the economic conditions of the country as a whole by increasing the demand for manufactured products. The processing tax was declared unconstitutional in 1936.

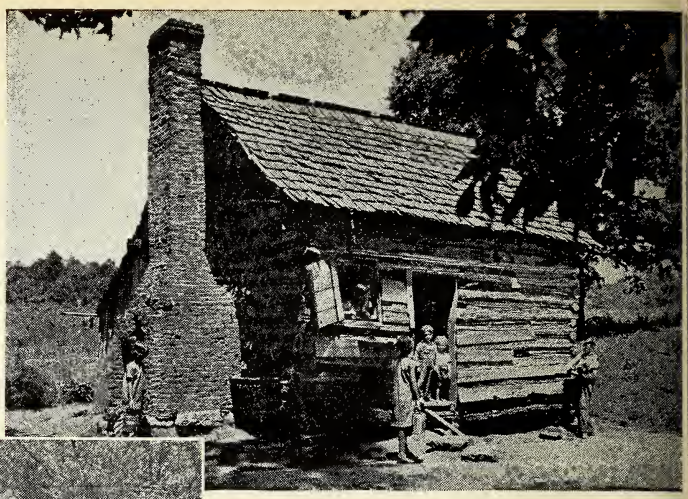
By means of so-called codes of fair competition, groups of traders and industrialists were induced to agree upon certain trade practices, wage scales, and hours of work. Pressure was brought to bear upon them to advance wages, but not to advance selling prices. The signing of a code automatically absolved the signer from prosecution under the anti-trust laws, but the President was charged with the responsibility of allowing no monopolistic tendencies to develop. This part of the government's economic program was also declared unconstitutional. The decision was rendered in 1935.

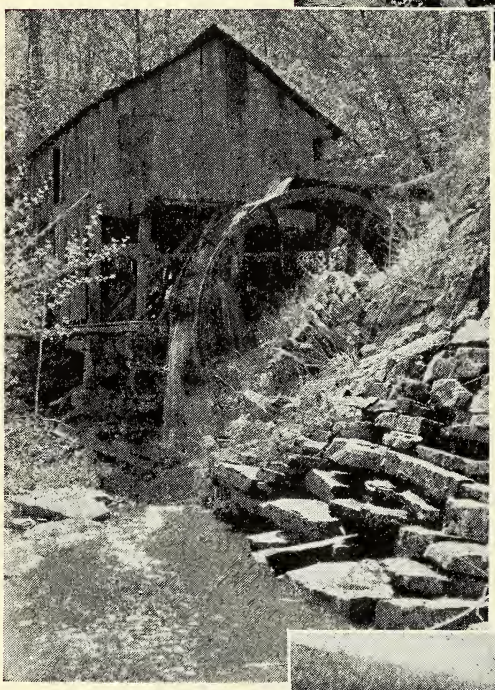
In an effort to limit speculation, to prevent unfair practices in security markets, and to assure adequate public information relating to securities in which public trading takes place, the government, during this same period, extended its sway into another field of economic life by the passage of the Securities Exchange Act of 1934.

At present the administration of the Act is vested partly in the Board of Governors of the Federal Reserve System and partly in a newly created body known as the Securities and Exchange Commission. The former is given control over credit granted for security transactions; the latter exercises jurisdiction over security markets and securities bought and sold in such markets.

The Act seeks to control the amount of credit that may be extended to finance marginal buying, and the amount that may be granted to brokers and dealers for trading purposes. Registration of all security exchanges is required to assure supervision; likewise, and for the same reason, all securities traded in on the exchanges, except those definitely exempted, must be registered. Various manipulative practices which serve no useful economic function but by means of which market operators have frequently profited at the expense

TYPICAL RURAL HOMESTEAD. MANY THOUSANDS OF FAMILIES IN THE TENNESSEE VALLEY HAVE NEVER KNOWN PROSPERITY IN ANY FORM.



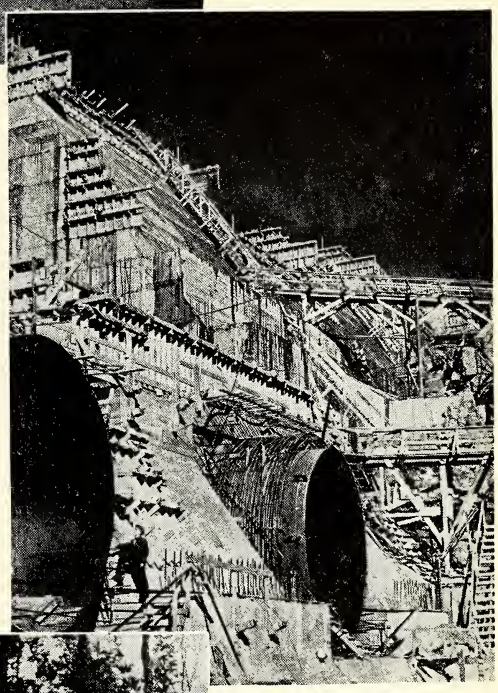


The Government in the Tennessee Valley

AN OLD MILL NEAR NORRIS DAM. INEFFICIENT AND INADEQUATE DEVELOPMENT OF WATER POWER HAS RETARDED INDUSTRIAL GROWTH.

A DEEP GULLY CUT BY THE EROSIVE ACTION OF WATER. RICH TOP SOIL HAS BEEN WASHED AWAY FOR SO MANY YEARS THAT IT IS DIFFICULT TO EKE OUT ANY EXISTENCE FROM THE GROUND.

GOVERNMENT AGENT IN A RURAL STORE HOLDING PERSONAL INTERVIEWS WITH APPLICANTS FOR EMPLOYMENT ON THE VAST RECLAMATION PROJECTS BEING CARRIED ON IN THE VALLEY.



PENSTOCK TUBES IN THE NORRIS DAM. FOUR THOUSAND CUBIC FEET OF WATER PER SECOND WILL GENERATE CHEAP POWER FOR FERTILIZER PRODUCTION AND INDUSTRIAL DEVELOPMENT AND HELP BRING PROSPERITY TO THE TENNESSEE VALLEY.

WORKER'S HOME IN NORRIS, TENNESSEE. MODEL HOMES, EDUCATIONAL OPPORTUNITIES, AND CLEAN AND WHOLESOME SURROUNDINGS HAVE BEEN MADE POSSIBLE FOR THE WORKERS ON THE GREAT NORRIS DAM.

of the public are wholly banned. The issuer of every registered security is required to disclose detailed information regarding the nature of the security, and to keep the information up to date by periodic reports.

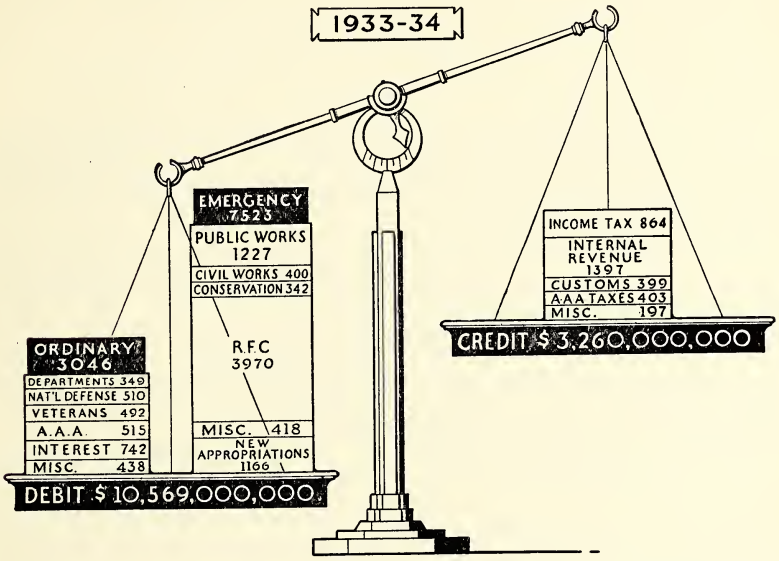
In the realm of employer-employee relationships, far-reaching legislation was passed by the government on August 14, 1935, in the form of the Federal Social Securities Act. The Act provides for old age pensions, retirement benefits, and unemployment insurance. It also provides for various grants-in-aid to the states for the assistance of dependent and crippled children, disabled and blind persons, and other welfare projects.

In the matter of pensions, appropriations (which must be matched by the states) are made by the Federal government to assist the states in carrying out their pension laws. The purpose of this Federal assistance is to care for the aged and needy persons who will reach age 65 before ample retirement benefits provided elsewhere in the law are available.

Retirement benefits are to be paid by the Federal government, beginning in 1942, to persons over the age of 65. These benefits are payable as a matter of right and should be distinguished from the pensions payable by the states to aged persons on the basis of need. Contributions from both employers and employees go to make up a fund from which retirement benefits are paid.

The unemployment insurance program, as planned by the Federal act, is to be carried out essentially by the states. A Federal tax is levied on employers. If a state has no unemployment insurance law meeting the standards set up by the Federal act, its citizens derive no direct benefit from the tax; if it has such a law, employers subject to it get relief from the Federal tax by being permitted to deduct from the Federal tax (up to 90%) the contributions made to the state fund. The contributions for the Federal part of the unemployment insurance program are to be made by employers only. The states may require contributions from employees as well, in order to increase the amount of benefits or to lengthen the period during which they are to be paid.

As a result of these and other increased activities of the government in economic life, together with the vast sums spent for public relief, public works, and other emergency programs, the expenses of the government have increased far beyond its income. The deficit has been made up very largely by borrowing. In the meantime, the government has divided its budget into two parts: (1) the ordinary budget, and (2) the emergency budget. These two budgets are compared with governmental income in the accompanying sketch.



The accompanying sketch shows the extent to which Federal expenses exceeded income for the period 1933–34. (From *The New York Times.*)

5. What does the sketch indicate concerning future taxation?

UNIT 2.—TAXES

Observations and Discussions.

1. Prepare in your notebook a chart made up of four horizontal bars each divided into 100ths. Entitle the chart "The Functional Distribu-

tion of American Governmental Expenditures, 1929." Label the first bar "Federal"; the second, "State"; the third, "Local"; and the fourth "Total." Divide the bars in accordance with the percentages specified below and connect with arrows the sections of the bars representing the same governmental functions.

Purpose of Disbursement	Percentage of Distribution [1]			
	Federal	*State*	*Local*	*Total*
Education	0.6	29.5	32.0	23.8
Highways	3.8	36.0	19.5	18.5
General government	16.9	6.8		
Protection	60.7	9.4		
Economic development	7.5	3.5		
Social welfare	3.4	13.6	48.5	57.7
Miscellaneous	0.7	0.4		
Public utilities	6.4	0 8		
Totals	100.0	100.0	100.0	100.0

2. (a) In 1929 what was the most important governmental function in the United States, judging by the standard of monetary expenditure? (b) What unit of government devotes the largest part of its expenditures to this work?

3. Judging by the same standards, what was the most important function of (a) the Federal government and how is this associated with war? (b) the state governments?

4. Refer to Case 107. (a) What is the average tax load per capita? (b) Make a "pie" chart showing how this is divided among the various units of government. (c) Make another "pie" chart showing how this is divided according to types of taxes.

5. If it is possible for the club to make a group visit to the local tax collector's office, appoint a committee of two to make the advance arrangements as usual.

Devote a page of your notebook to a description of the observations made during the visit. Use the following headings: (a) how the amount of the general property tax to be collected by the municipality is ascertained; (b) how real property is rated—that is, valued by the tax assessor; and (c) how the tax rate is computed.

Although methods for the determination and collection of the general property tax differ among the various states, it is frequently customary for the state first to apportion among the counties the sum necessary for its estimated expenses. The apportionment is made according to the value of the taxable property within each county. Each county then adds

[1] Shultz, William J., *American Public Finance and Taxation,* p. 28.

AVERAGE TAX LOAD IS $77 PER CAPITA

Report to House Committee Shows a 14 Per Cent Rise From 1922 to 1931.

RURAL BURDEN HEAVIEST

Amount Is Five Cents Higher on Each $100 Than in Largely Urban States.

WASHINGTON, Jan. 19 (AP).—An analysis of the national tax picture revealing an average yearly burden on every citizen of $77.53 was made public today by House Ways and Means Committee experts in preparation for steps toward eliminating some of the 326 cases of overlapping State and Federal taxation.

"Total Federal expenditures have increased nearly seven times in the last twenty years," the experts said.

Per Capita Rise Is $9.26.

"This increase amounts to $9.26 per capita, or nearly 14 per cent. Leaving out of account Federal taxes, the per capita tax burden of all other taxes amounted to $38.85 in 1922 and to $57.76 in 1931. This increase amounted to $18.91 per capita, or about 48 per cent."

The average burden of State and local taxes on every $100 of estimated wealth was 5 cents more in 1931 in predominately rural than in more urban States, the compilation showed. The average levy for every $100 of wealth in States chiefly rural was put at $3, as compared to $2.95 for the urban group.

This does not include Federal taxes, but to get the total tax burden per $100 of taxable wealth $1.01 can be added to the figures mentioned.

This is how it shapes up by States:

Rural.

Maine	$3.67	South Carolina	3.43
Vermont	3.87	Georgia	2.73
Minnesota	2.58	Tennessee	3.51
Iowa	3.33	Alabama	2.47
North Dakota	3.05	Mississippi	3.52
South Dakota	2.70	Arkansas	3.46
Nebraska	2.54	Louisiana	3.36
Kansas	3.62	Montana	2.50
West Virginia	3.53	Idaho	2.23
Kentucky	2.54	Wyoming	2.88
Oklahoma	3.45	New Mexico	2.14
Texas	2.70	Arizona	2.73
Virginia	3.33	Nevada	2.48
North Carolina	3.42		

Urban.

New Hampshire	$3.40	Michigan	3.06
Massachusetts	3.34	Wisconsin	3.50
Rhode Island	2.59	Missouri	2.11
Connecticut	2.30	Maryland	3.22
New York	3.38	D. of Columbia	1.66
New Jersey	2.69	Colorado	2.98
Pennsylvania	3.47	Utah	3.06
*Delaware	6.24	Washington	3.76
Ohio	3.03	Oregon	2.12
Indiana	3.65	California	2.37
Illinois	2.01	Florida	3.00

*(Delaware has no State general property tax and the report said this figure should not be given too much weight.)

Statistics of Tax Survey.

Some of the important tax facts prepared by the experts are as follows:

Total 1931 Tax Revenues.

Type of Tax.	Amount.
Federal taxes	$2,428,000,000
State tax	1,967,000,000
County taxes	958,000,000
City taxes	2,978,000,000
Local taxes	1,188,000,000

How the $77.53 Per Capita Tax Burden Is Divided.

Division.	Amount.
Federal government	$19.77
State governments	16.02
County governments	7.80
City governments	24.26
Other local governments	9.68

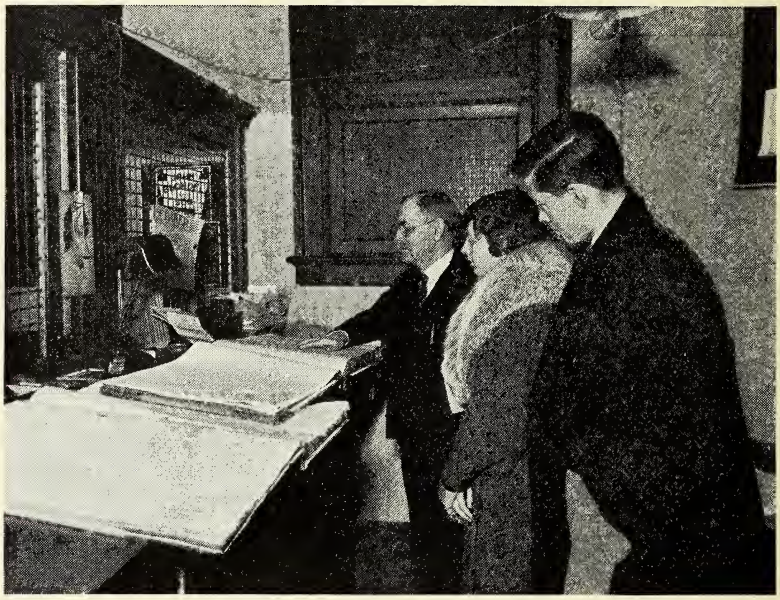
How the $77.53 Is Raised.

Type of Tax.	Amount.
General property tax	$41.47
Franchise taxes	2.77
Income taxes	16.45
Estate and inheritance taxes	1.88
General sales taxes	.04
Special sales taxes	8.75
Poll taxes	.15
Licenses and permits	4.13
Special assessments	1.75
Miscellaneous	.14
Total	$77.53

CASE 107

The New York Times.

to the sum apportioned it by the state an additional amount covering the cost of the county government. This total is then apportioned among the municipalities located within the county, the apportionment being made according to the value of the taxable property within each municipality. Each municipality then adds to the state and county bill what it needs to cover the cost of municipal government and apportions the



Students at a Local Municipal Building Examining the Tax Ledgers.

total among the various property owners within the municipality. Each property owner, therefore, receives one bill covering the municipal, county, and state tax.

The total tax bill for each municipality divided by the total value of the taxable property within that municipality is called the *tax rate* and is expressed in so many dollars and cents per $100.00. The taxable property is called the *ratables.* It will at once be seen that the matter of valuing property for the purpose of taxation is exceedingly important. A municipal officer called the *tax assessor* is selected for this purpose. According to law, he is obliged to value all property according

to its real and true value. This, however, is always difficult to determine; differences of opinion invariably arise, therefore, which are adjusted by boards set up for that purpose.

6. Refer to your chart drawn in connection with question 4 (c). In point of importance from a revenue-producing standpoint, what is the most important tax in the United States?

Over one hundred and fifty years ago, Adam Smith set forth his four famous canons of taxation. These may well be used today as standards by which to judge a tax. Smith's canons of taxation are as follows:

> ABILITY. "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."
>
> CERTAINTY. "The tax which each individual is bound to pay ought to be certain, not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person."
>
> CONVENIENCE. "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it."
>
> ECONOMY. "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."

Ability to pay may be measured by the possession of wealth or by the receipt of income. In either case, the tax may be based on the gross or the net wealth or income—that is, the total wealth or the total income, if the gross is considered—the total income less the indebtedness, or the total income less the cost of gaining it, if the net be selected.

Whichever measure be used, the tax may be applied in several ways: *proportionate* taxation, *progressive* taxation, or *regressive* taxation. A tax is said to be proportionate when the same percentage or tax rate is applied to all taxable amounts. If, for example, *A* is taxable to the extent of $5,000.00, *B*, $10,000.00, and *C*, $15,000.00; and if the tax rate is, say, $2.00 per $100.00; *A*'s tax is $100.00, *B*'s, $200.00,

and *C*'s, $300.00. In the case of progressive taxation, the tax rate increases as the sums taxable increase. Thus, in the example, if the tax rate on $5,000.00 is $2.00 per $100.00, or $100.00, the rate on $10,000.00 might be $2.25, or $225.00, and the tax rate on $15,000.00 might be $2.50, or $375.00. Regressive taxation is just the opposite of progressive taxation. The tax rate decreases as the amounts taxable increase. If the tax rate on $5,000.00 is $2.00, or $100.00, the tax rate on $10,000.00 might be $1.75, or $175.00, and on $15,000.00 the rate might be $1.50, or $225.00.

It is apparent that, judged by Adam Smith's first canon of taxation, a regressive tax is open to adverse criticism; and even a proportionate tax might be similarly questioned. A progressive tax, however, seems fully to meet the requirement. Because of these circumstances, perhaps, regressive taxation as such is not found in the United States. We shall see, however, that certain of our taxes do have a regressive effect.

7. (a) Is the general property tax based on gross or net wealth or income? Is it proportionate, progressive, or regressive? (b) Judge it from the standpoints of: ability to pay, certainty, economy, and convenience.

8. If in the process of assessing property for the purpose of taxation, the range between the "true" value and the "assessed" value is greater in the case of the large properties than in the case of the small properties, show how the tax is in reality regressive.

9. Refer to your chart drawn in connection with question 4 (c). In point of importance from a revenue-producing standpoint, what kind of tax is next in importance to the general property tax?

10. The following schedule is the surtax rates for the United States income tax for 1929:

Amount of Net Income	*Rate*	*Amount of Net Income*	*Rate*
$ 0 to $10,000.....	0%	$ 40,000 to $ 44,000.....	11%
10,000 to 14,000.....	1	44,000 to 48,000.....	12
14,000 to 16,000.....	2	48,000 to 52,000.....	13
16,000 to 18,000.....	3	52,000 to 56,000.....	14
18,000 to 20,000.....	4	56,000 to 60,000.....	15
20,000 to 22,000.....	5	60,000 to 64,000.....	16
22,000 to 24,000.....	6	64,000 to 70,000.....	17
24,000 to 28,000.....	7	70,000 to 80,000.....	18
28,000 to 32,000.....	8	80,000 to 100,000.....	19
32,000 to 36,000.....	9	100,000 up ———.....	20
36,000 to 40,000.....	10		

What is the surtax on a net income of $50,000?

Think:

On the first	$10,000...	0%	On the next	$ 4,000...	8%
on the next	4,000...	1	on the next	4,000...	9
on the next	2,000...	2	on the next	4,000...	10
on the next	2,000...	3	on the next	4,000...	11
on the next	2,000...	4	on the next	4,000...	12
on the next	2,000...	5			
on the next	2,000...	6	TOTAL	$48,000	
on the next	4,000...	7			
			Over $48,000 to $52,000	2,000...	13
			TOTAL	$50,000	

11. Is the income tax based on gross or net wealth or income? Is it proportionate, progressive, or regressive? Judge it from the standpoint of ability to pay.

12. From the following figures, compare customs receipts with the income tax from the standpoint of the fourth canon mentioned by Adam Smith—economy:

	Millions and Tenths of Millions
Customs receipts	$602.3
Cost of collection	20.8
Income and profits tax	$2,330.7
Cost of collection	33.0 [2]

13. Consider a general sales tax from the standpoint of ability to pay.

Think: Consider a general sales tax of 1%. *A* has an income of $7,000, and *B*, an income of $3,500. What is their relative tax-paying ability? Each spends $3,000 a year. Each pays a tax, therefore, of how much? What proportion of the income is the tax in each case?

When taxes can be passed on to others by the person who first pays them, they are said to be *indirect;* when they cannot be so passed on, they are said to be *direct.* Those paying direct taxes are, of course, conscious of paying them; those

[2] *Statistical Abstract of the U. S., 1930,* pp. 171, 178.

who ultimately pay indirect taxes, however, are seldom conscious of the fact that they are being taxed. A person paying an income tax, for example, pays it direct to the government and has no means of passing it on to others. A person buying a pound of imported sugar, on the other hand, pays the import tax in an amount added to the price of the sugar, but since this added amount is not specified, it is not noticed.

DR. BUTLER DEMANDS BROADER TAX BASIS

If All Citizens Had to Pay Direct Levies They Soon Would End Waste, He Holds.

ASSAILS PUBLIC'S APATHY

Declares It Has Encouraged Selfish Interests to Build "Staggering Burden."

Revision of the tax system to make the mass of citizens instead of a small portion bear the burden was described by Dr. Nicholas Murray Butler, president of Columbia University, in a speech last night as the one sure road to government economy and a general public interest in the workings of government.

"The vast majority of the American people are not tax-conscious," he declared. "If we could so revise our system of taxation as to make them tax-conscious, as they should be, governmental economy would follow as surely as night follows day."

CASE 108

The New York Times.

14. Refer to Case 108. Why would a substitution of direct for indirect taxation perhaps tend to make people more interested in governmental affairs?

15. Refer to the chart, "Fundamental Relationships in Economic Life," on page xii in the front of the book. How may taxation influence the distribution of wealth?

Conclusions.

A. What is meant by laissez-faire?

1. What problem in reference to this policy is a capitalistic society called upon to solve?
   (a) What were Adam Smith's ideas in the matter?
   (b) Has the policy been an unqualified success?
   (c) What tendencies can be noted?

2. What attitude has the government taken in recent years?
   (a) In the matter of agriculture?
   (b) In the matter of industry?
   (c) In the matter of security and exchange regulations?
   (d) In the matter of economic security?
3. How was the new policy financed?
   (a) What is meant by the regular and the emergency budgets?
   (b) What is the effect upon taxation?

B. For what was most of the public money spent in 1929?

1. About what is the present tax load per capita?
   (a) How is the tax load divided among the various units of government?
   (b) How is it divided among the different types of taxes?
2. What are Adam Smith's canons of taxation?
   (a) How may ability to pay be measured?
   (b) What is proportionate, progressive, and regressive taxation?
   (c) Criticize the general property tax.
   (d) Criticize the personal income tax.
   (e) Wherein do import duties as a revenue producer fail to conform to Adam Smith's canons?
3. What is direct and indirect taxation?
   (a) What have these to do with interest in governmental matters?
4. How may taxation influence the distribution of wealth?

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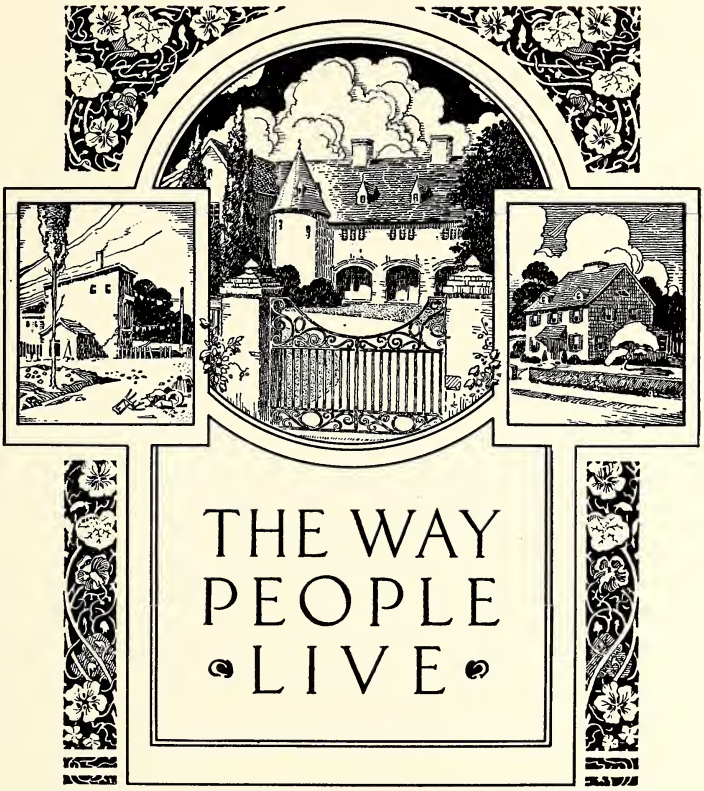
CHAPTER XVII



THE WAY PEOPLE LIVE

CHAPTER XVII

The Way People Live

UNIT 1.—RICHES AND POVERTY

Observations and Discussions.

1. This is a group project and should be divided among the members of the club according to the circumstances prevailing in the particular community in which the club is located. Appoint a committee to outline the investigation and to apportion the field work.

Arrange a table in your notebook such as the one shown in the accompanying illustration:

Annual Rent (1)	*Location* (2)	*Description* (3)	*Estimated Income* (4)	*Number of Families* (5)	*Per cent of total* (6)

One or more real estate brokers should now be visited. Explain that you represent a school group engaged in a serious study of the economic life of the community, and most brokers will be glad to help you. Find out the prevailing monthly or annual rents of various types of residences in different sections of the community. From this data fill in columns 1 and 2 in your table.

Now visit the localities mentioned and fill in column 3 with descriptions of particular habitations.

Next, refer to the following statistics and fill in columns 4, 5, and 6 of your table:

THE NUMBERS OF FAMILIES BY INCOME CLASSES, 1929 [1]

Income Class (In Dollars)	*Families (In Thousands)*	*Families (As Percentage of Total)*
Under 500	2,102	7.651
500 to 1,000	3,797	13.820
1,000 to 1,500	5,754	20.943
1,500 to 2,000	4,701	17.111

[1] Leven, Moulton, and Warburton, *America's Capacity to Consume,* p. 54.

Income Class (In Dollars)	Families (In Thousands)	Families (As Percentage of Total)
2,000 to 2,500	3,204	11.626
2,500 to 3,000	1,988	7.236
3,000 to 3,500	1,447	5.267
3,500 to 4,000	993	3.614
4,000 to 4,500	718	2.613
4,500 to 5,000	514	1.871
5,000 to 6,000	666	2.424
6,000 to 7,000	407	1.481
7,000 to 8,000	252	.917
8,000 to 9,000	172	.626
9,000 to 10,000	128	.466
10,000 to 15,000	304	1.107
15,000 and over	327	1.191
All classes	27,474	100.000

INCOME EQUIVALENTS FOR SPECIFIED AMOUNTS OF RENT PAID [2]

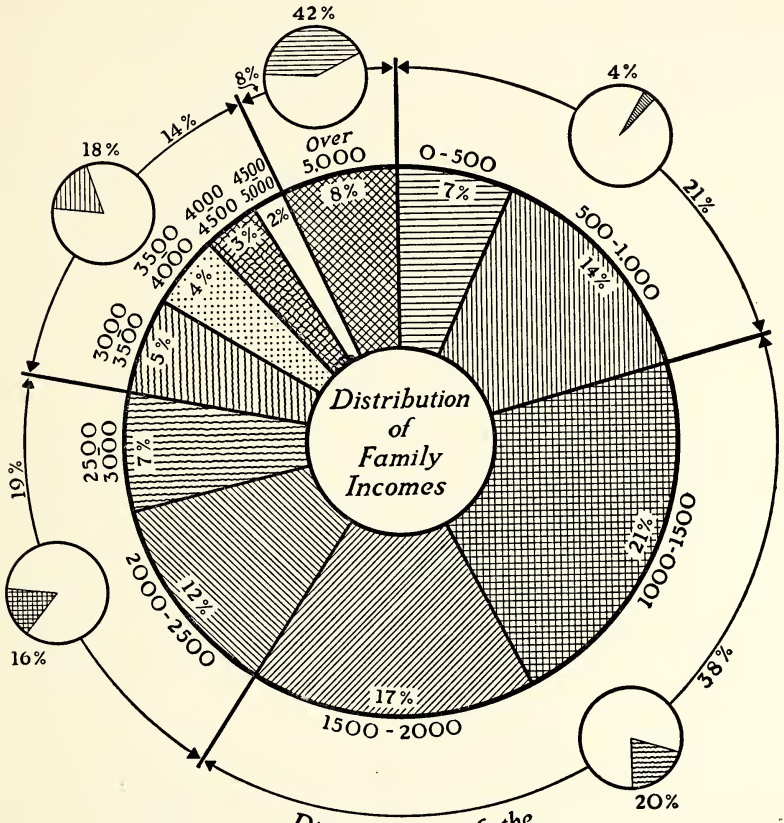
Annual Rent	Family Incomes: Urban	Family Incomes: Rural Non-Farm
$ 100	$ 800	$ 1,120
200	1,160	1,624
300	1,575	2,205
400	2,060	2,884
500	2,560	3,584
600	3,080	4,312
800	4,110	5,754
1,000	5,150	7,210
1,500	7,720	10,808
2,000	10,300	14,420
2,500	12,850	17,990

If your club is located in a city or within easy commuting distance of a city, use the first column under "Family Incomes"; if your club is located in a small town surrounded by farm lands, use the second column.

Rents will differ widely among different communities; a given sum will purchase much more in the way of housing in some places than in others at the same period of time. It cannot be inferred, therefore, that the living conditions at any given rent level found in any one community at any one time are representative of living conditions at that rent level at

[2] Leven, Moulton, and Warburton, *America's Capacity to Consume,* p. 223.

the same period of time throughout the nation. In any given locality, however, the type or types of dwellings occupied by the wage-earning classes may be readily determined.[3] Likewise, the dwellings occupied by the very wealthy classes are



Distribution of the National Income, 1929

easily distinguishable. Between these two extremes is usually to be found a wide range of dwellings occupied by the middle classes. At least this rough classification may be obtained, it is believed, by an examination of rents, and in this way contrasts in the living conditions among different income

[3] National Industrial Conference Board, *The Cost of Living in the United States,* 1924–1927, p. 24.

groups may be noted in almost any community, although the general levels as a whole will vary in different communities.

The chart[4] on page 313 represents the distribution of the national income in 1929. The national income is the sum total of all personal incomes; it is the total amount of wealth created by productive effort within the nation during a given period of time.

The large circle represents the total number of families in the United States. The divisions of the large circle show the number of families in different income groups.

The small circles each represent the total national income. The divisions show how this income was distributed among the various numbers of families—the percentage of the total number of families being indicated by outer arcs of the large circle.

Thus, the large circle shows that in 1929:

7%	of	the	families	received	an	income	of	between	$ 0	and	$ 500
14%	"	"	"	"	"	"	"	"	500	"	1,000
21%	"	"	"	"	"	"	"	"	1,000	"	1,500
17%	"	"	"	"	"	"	"	"	1,500	"	2,000
12%	"	"	"	"	"	"	"	"	2,000	"	2,500
7%	"	"	"	"	"	"	"	"	2,500	"	3,000
5%	"	"	"	"	"	"	"	"	3,000	"	3,500
4%	"	"	"	"	"	"	"	"	3,500	"	4,000
3%	"	"	"	"	"	"	"	"	4,000	"	4,500
2%	"	"	"	"	"	"	"	"	4,500	"	5,000
8%	"	"	"	"	"	"	"	"	Over	"	5,000

The small circles show that:

4%	of	the	national	income	was	distributed	among	21%	of	the	families
20%	"	"	"	"	"	"	"	38%	"	"	"
16%	"	"	"	"	"	"	"	19%	"	"	"
18%	"	"	"	"	"	"	"	14%	"	"	"
42%	"	"	"	"	"	"	"	8%	"	"	"

2. Refer to the above diagram or to the completed tabulation compiled from your field studies. (a) What inferences can you draw as to the relative amount of wealth and poverty in the United States? (b) Where does the greatest disparity between national income and family income occur—in the higher, lower, or middle income levels? Illustrate.

3. Refer to Cases 109 and 110. Is the contrast suggested by these

[4] Adapted from Leven, Moulton, and Warburton, *op. cit.*

$1,000,000 in Gifts For Astor's Bride

$50,000 Bracelet, $15,000 Car Already Given by Young Millionaire

NEWPORT, R. I. (U.P.)—John Jacob Astor's gifts to Ellen Tuck French, who becomes his bride Saturday, may represent well over $1,000,000, it was estimated today.

Already the young millionaire, who

CASE 109

Newark Evening News.

FINDS U. S. LACKING IN HOMES, CLOTHES

R. S. Doane Says We Need 2,000,000 New Houses Yearly—"1/3rd of a Garment a Man"

The United States is failing today to meet the adequate food requirements of its people to the extent of nearly 100 billion pounds of foodstuffs, Robert S. Doane, research director of the National Survvey of Potential Product Capacity says in an article in the New Outlook. The findings of the Survey indicate an accumulated shortage in excess of 6,000,000 dwellings, Mr. Doane says.

"On the basis of modern sanitary and living comfort standards, it will take the American people 15 years at an annual outlay of 10 billion dollars to bring our housing facilities up to a reasonable level," Mr. Doane says. "Recent findings indicate that we need to build new homes at the rate of 2,000,000 per year during the next five years. Yet our capacity due to present limitations in supplying materials, transporting them, and in construction technology, will not permit, today in America, the building of more than 200,000 such structures per annum."

In 1929, the male population of the United States were supplied on a per capita basis, with a bare one-third of a garment of new outerwear while capacity on a plant basis was barely able to supply a fraction less than a single new suit of clothes for each male, Mr. Doane says. "In other words, in this land of plenty, where two new suits of clothes per year might be a reasonable expectation, the American ability—with existing plant equipment and material capacities taken into consideration—disclosed a deficiency of some 66,000,000 suits."

The country's transportation equipment would be taxed to the utmost if the country were to attain but 50% of the standard of living laid down by the U. S. Department of Agriculture, Mr. Doane said.

CASE 110

Wall Street Journal.

two news items revealed in the diagram appearing on page 313 or in your table?

4. Refer to Case 110. Is the description justified?

UNIT 2.—DISTRIBUTION OF THE NATIONAL INCOME

Observations and Discussions.

1. Consult the chart, "Fundamental Relationships in Economic Life," on page xii in the front of the book. (a) Upon what does the distribution of the national income depend? (b) What phase of this subject has already been considered?

Those who own land derive an income from it in the form of *rent;* those who own capital receive *interest* for its use.

In popular language it is said that a landlord receives "rent" for a house. In the technical language of economics, however, the landlord receives "rent" only for the land on which the house is built. The house itself is capital in the strict sense of the term, and only interest is paid for the use of it. Because the two items are, in common practice, combined into one, it is convenient to refer to the total as "rent." When this is done, the term "ground rent" is sometimes used to distinguish the income received for the use of the land alone.

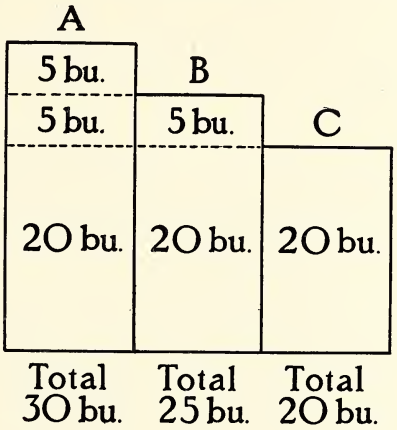
Rent can best be understood by first seeing how it arises in the case of agricultural land in a newly populated region, for the same principles that can so readily be seen at work under such elemental conditions are likewise applicable to every rural and urban community today.

At the outset it is necessary to keep in mind the distinction between *economic rent* and *contract rent.* Contract rent is the amount which a tenant actually pays for the use of a given piece of land. It is the result of a bargaining process. Contract rent fluctuates about a theoretical figure known as "economic rent." Economic rent is not the result of any bargaining process; it depends upon the earning capacity of the land.

Imagine, for example, a newly populated region made up of

different plots of land alike in every respect except in the matter of fertility. With equal amounts of capital and labor expended, land *A* will yield, say, 30 bushels of wheat per acre; land *B*, 25 bushels per acre; and land *C*, 20 bushels per acre. This condition is shown by rectangles in the accompanying illustration.

Land *A* will naturally be the first to be settled, and so long as there is plenty of *A* land available for anyone who wishes to claim it, obviously no rent can be collected for its use. When land A is completely settled, however, additional new-



comers may do one of two things: they may settle land *B*, or they may rent land *A* from those already in possession of it. On land *B* the newcomers can raise 25 bushels per acre and pay no rent. On land *A* they can raise 30 bushels of wheat per acre and pay the equivalent of 5 bushels of wheat per acre to the owner as rent. That this must necessarily be the economic rent can be seen by reference to the law of supply and demand. If the rent were less, then it would be to the advantage of every newcomer to rent land *A*. The demand for land *A* would be great, but the supply is definitely limited; the price, therefore, would advance. If it advanced beyond the equivalent of 5 bushels of wheat per acre, however, it would be to the advantage of every newcomer to occupy land *B*. There would consequently be no demand for

land *A*. Those owners of land *A* desiring to rent their farms could not do so, and the price would go down.

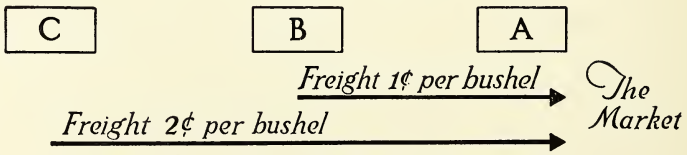
With the complete settlement of land *B*, additional newcomers have three alternatives: they may rent land *A*, they may rent land *B*, or they may settle land *C*. If they settle land *C*, they can raise 20 bushels of wheat per acre and pay no rent. If they rent land *A*, they can raise 30 bushels of wheat per acre and pay in rent the equivalent of 10 bushels of wheat per acre. If they rent land *B*, they can raise 20 bushels of wheat per acre and pay in rent the equivalent of 5 bushels of wheat per acre.

It will be seen from this discussion that economic rent is really the amount of net gain that a given piece of land is capable of earning.

2. (a) Show how a landowner in a rapidly growing agricultural community might eventually receive an income in rent sufficient to support him in idleness by simply retaining ownership of a piece of land. (b) Do you think that such a situation is a good thing for the economic life of the community?

3. In the state of Illinois in 1920, the United States Census showed that in the rich soil areas 57% of all the farms were operated by tenants, while only 28½% of the farms in the poorer counties were operated by tenants. Explain why in rich soil areas a tenant class of farmers tends to develop.

Earning power of the soil may be dependent upon other factors than fertility. Proximity to market, for example, may create differences in earning power.



4. In the above diagram it is assumed that in all three plots, *A*, *B*, and *C*, all conditions are the same except proximity to the market. Let us say each plot is 100 acres and in each plot 30 bushels of wheat are raised per acre. (a) When the demands of the market are such that wheat is shipped from land *B*, how much will this add to the economic rent of land *A*? (b) When the demands of the market are

such that wheat is shipped from land *C*, how much will be added to the economic rent of land *A*? (c) of land *B*?

5. Earning capacity of the land is often influenced by the use to which the land may be put. This, in turn, often depends upon the development of the community. As a community grows, the residential and shopping areas push out into the farm regions. The movement is often stimulated by land development companies that buy farm lands by the acre, and sell the land by the city lot. How will farm rents in such areas be affected?

In the case of retail stores, earning capacity of the land often depends upon the number of people who pass the plot. There are, of course, various kinds of retail stores on a city block. The particular conditions surrounding each business, the element of management, and the particular location on the block, as well as a host of other factors, make it impossible to segregate economic rent as clearly as can be done in the case of agricultural land. The fact that, in retail stores as well as on farms, rent tends in general to absorb net gains is a matter of common observation as well as painful experience to the retail merchants who do not own their own properties or who are not protected by long-term leases.

6. A shoe store located on the less desirable side of the street sells 100 pairs of shoes a week at an average price of $5.00 All expenses exclusive of rent amount to $400.00 per week. Owing to a favorable lease, the contract rent is $75.00 per week. (a) What is the economic rent? (b) Is the contract rent likely to be advanced at the termination of the lease? (c) If the enterprise moves across the street, and, by virtue of the more favorable location, is able to sell 150 pairs of shoes per week at no additional expense, what will be the economic rent?

7. Have you observed that in a rapidly growing community there are many changes in the retail stores within a comparatively short length of time? Why is this?

8. Land values depend upon land rents in exactly the same way as the normal market value of the capital stock of a corporation depends upon dividends. The process of calculating land values from land rents is called *capitalization*. Review question 8 on page 47. If the current rate of interest is 6% and a given piece of land is yielding a rent of $100.00 per month, what is the capitalized value of that piece of land?

9. Refer to question 5 above. In an area such as the one described, how might it become comparatively unprofitable for a farmer to work his own farm?

Think: Are rents increasing or decreasing? How are land values affected? At the current rate of interest, how high will land values have to go to make the farm comparatively unprofitable?

10. Just as the market value of a capital stock tends to anticipate earnings of the company, so the market value of land tends to anticipate changes that will affect the earning capacity of that land. How will the news of increased transportation facilities or new industries that will increase the population affect land values?

Two important differences should be noted between rent and interest. In the first place, rent can be stated in terms of dollars because rent always applies to a definite piece of land. Interest, however, cannot be so expressed because capital can take innumerable forms. When capital is borrowed, it is money or credit that is first advanced. The borrower converts this into such capital as he desires. The price paid for the use of this capital, then, is quoted as a per cent of the money or credit originally granted. This is called the interest rate. In the second place, while land is definitely limited, capital is not. The interest rate, therefore, shows no tendency to advance constantly as civilization develops. Quite the contrary. In a new country where the opportunities for the creation of wealth are great but where the accumulation of capital is small, interest rates are high. As the land is developed, however, and the opportunities become fewer, while the savings increase and make capital more readily available, the interest rate falls.

In the realm of practical affairs, commercial interest rates always are influenced by risk. Strictly speaking, however, payment for risk is something different from payment for the use of borrowed capital. Because both are fused into the same amount, the term *pure interest* is used to signify simply that which is paid for the use of capital regardless of other considerations.

11. Interest is simply a means of paying people for saving. If people were not paid for saving, do you think that a sufficient supply

of capital would be created to replace the constant loss occasioned by wear and obsolescence, to say nothing of satisfying the demands for additional capital?

12. Three months of the year a farmer employs ten men, each at $100.00 per month. He has a capital equipment amounting to $15,000.00 and the prevailing interest rate is 6%. With the factors of production arranged in this proportion, the farmer has always been more than able to cover expenses. With the addition of $15,000.00 in new and improved agricultural machinery, the farmer finds that he can dispose of the services of seven of the men and still maintain his production. Show that the farmer can afford to borrow the money, pay the interest, and eventually return the capital.

13. Wealth was created rapidly in England during the early years of the Industrial Revolution, but England is a small country and the opportunities for the employment of wealth at large returns were soon exhausted. England then became the leading nation for foreign investments. Explain this in terms of interest rates.

The number of people has an important bearing upon the third form in which the national income is distributed—wages. As rent is the return for land, and interest the return for capital, so the compensation for labor takes the form of wages. When the demand for labor is great and the number of workers is small, wages are high; as the supply of workers increases, wages fall. In observing employer-employee relationships as outlined in Chapter X, we gained some notion of the bargaining process by which wages are determined. Workers have gained much by collective bargaining, but even so, when there are more applicants than jobs, the bargaining power is against them.

So long as economic society is constructed on an acquisitive basis, it is hard to see how this can be otherwise. Management is intent upon gaining profits. Profit is a residue, something left over after costs are met. Contract rent is an element of cost, interest is another, wages another. To the extent that these are kept low, profits are high. Profits, however, like rent and interest, go to owners, while wages, for the most part, go to the non-property-owning classes. The net result in a profit economy where labor is plentiful is an overwhelming advantage on the side of ownership as against wages.

NYE LAYS OUR ILLS TO POWER OF THE FEW

They Squeeze Wealth From the Rank and File, He Says Here, Urging Redistribution.

Until there is a drastic redistribution of wealth from the hands of the few into the hands of the many there will be no recovery from the depression, Senator Gerald P. Nye of North Dakota told a meeting held last night in the Labor Temple, 242 East Fourteenth Street.

"Never in the history of civilization have the people been so thoroughly fooled in the belief of prosperity as in America in the period leading up to 1929," he said. "Capitalists were constantly squeezing the wealth from the rank and file into the hands of a few."

The system has not yet ceased, he declared, adding that the very people who made such enormous profits were the ones now hoping to rid themselves of the bulk of tax burdens by fostering a sales tax that would place the burden of taxation directly on the masses who are now overburdened to the breaking point.

He then discussed the possibility of revising the cost of government in America. First pointing out that three-fourths of each dollar collected by the government goes to defray the expenses of a past war or to maintain an army and a navy for some future war, he said, the military divisions of the government were the only possible places for cuts in expenditures. He reported that the present cost of the army and navy was nearly three times as great as in 1915 and one-third greater than in 1926. The increases for various powers, he said, were 42 per cent for Great Britain, 30 per cent for France, 44 per cent for Italy, 31 per cent for Russia and 197 per cent for the United States.

"Yet we set ourselves up and call ourselves leaders in the movement toward world peace," he said. "We are talking one thing while under cover of darkness we are practicing another."

CASE 111

The New York Times.

14. Refer to Case 111. (a) If you were called upon to propose a plan that would bring about a more even distribution of the national income, what would you propose? (b) Do you think that such an object would be wise? (c) Do you think that it would be permanent?

Conclusions.

A. What is the national income?

1. Give some idea as to its distribution among the families of the United States.
   (a) Where does the greatest disparity occur?

B. In what ways is the national income distributed?

1. How is economic rent determined?
   (a) What is ground rent? Contract rent?
   (b) What conditions may influence the earning capacity of the land?
   (c) How are land values determined?
2. What governs the amount of interest?
   (a) Why must interest be paid?
   (b) How can interest be paid?

3. What governs the amount of wages?
   (a) Explain why in a profit economy the advantage is on the side of ownership.

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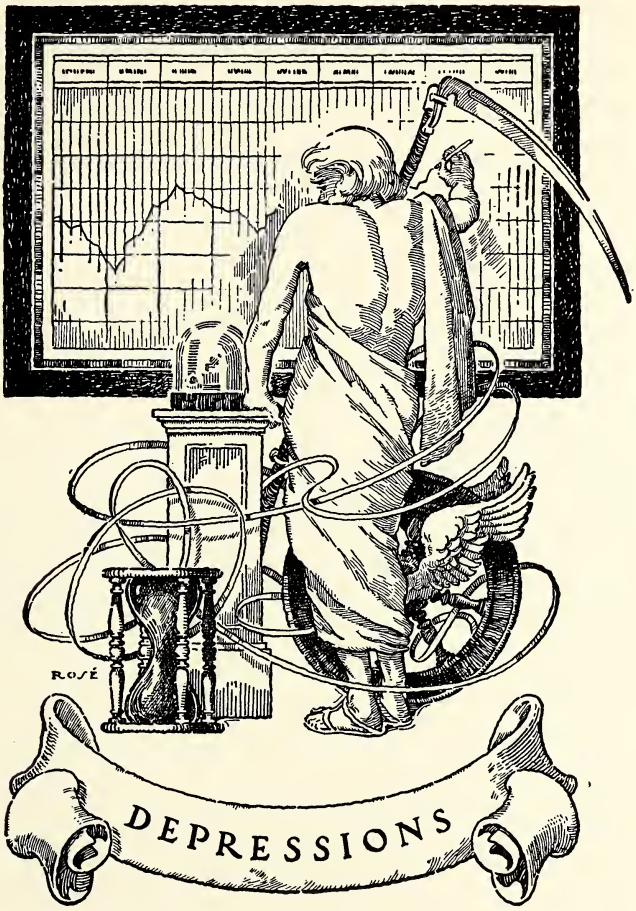
CHAPTER XVIII



CHAPTER XVIII

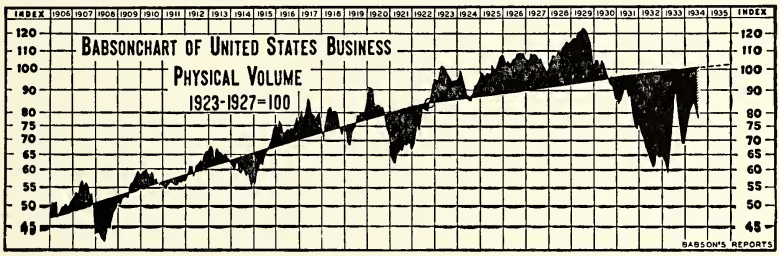
Depressions

UNIT 1.—ECONOMIC DEPRESSION

Observations and Discussions.

Are depressions chronic?

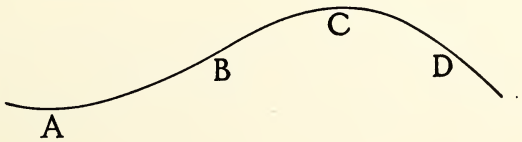
Refer to Case 112. Depressions have occurred at more or less regular intervals throughout a long term of years. This gives credence to the argument that such periods are an inherent part of our economic life. It would seem that the very



CASE 112 *Babson's Reports, Inc.*

forces that engender economic activity create conditions that bring about constantly recurring periods of prosperity and depression.

Those who emphasize this point of view point to the existence of four periods in every so-called business cycle the characteristics of which are as follows: [1]



[1] Adapted from Schulter, E. W. C., *Economic Cycles and Crises.*

A. Period of depression and dejection. Economic conditions: prices at "bottom"; low costs; business efficient; high bank reserves; low interest rates; dealers' stocks exhausted; sound foundation for renewed demand to stimulate the productive system. Social conditions: unemployment at its height; low standard of living; discouragement; resentment against unfairness of the economic system; willingness to work because of need.

B. Period of revival and renewed hope. Economic conditions: upward trend in prices; increased production activity; more employment and increased purchasing power; relatively

A Distressing Depression Scene.
Unemployed herded together in an armory during a cold winter day.

low costs and high selling prices; larger profits; tendency towards expansion; interest rates low compared with selling prices; bank loans heavier and more numerous; labor efficient; management alert; growing optimism as to business conditions. Social conditions: renewed feeling of security; a higher standard of living attained through renewed purchasing; labor disputes because of lag in wages.

C. Period of prosperity and realized hopes. Economic conditions: prices at peak high; feverish production activity; rapidly rising production costs; profits checked; increased interest rates; credit expansion checked; large stocks of goods on hand; labor increasingly inefficient; management careless; growing apprehension as to business conditions. Social conditions: extravagance and waste; over-confidence; attainment of maximum

standard of living; employment at its height; general optimism.

D. Period of recession and disillusionment. Economic conditions: decline in price level; production activity curtailed; wage cuts; slowing up in the consumption of goods and services; sharp reduction in bank loans; failures and bankruptcies numerous. Social conditions: increased unemployment; fear for economic security; standard of living impaired; ownership of homes, farms, and small business enterprises jeopardized because of inability to meet debts.

1. Follow the cause and effect sequence of events through the four periods of the business cycle as follows: (a) Why is demand increased as period *A* develops? (b) What effect has this upon profits? (c) How might the advent of a new industry offering some popular device lead the way out of a depression? (d) What effect has increased demand upon prices when stocks are depleted? (e) How will increased bank loans affect prices? (f) What change in the velocity of circulation of money takes place during period *B*? (g) What effect will these changes have upon the price level? (h) What general effect will the change in the price level have upon economic conditions in general? (i) What effect will the high interest rates in period *C* have upon bank loans? (j) How will peak prices affect buying? (k) How will these circumstances ultimately affect the price level? (1) What will be the effect upon business conditions in general? (m) How will wage cuts and unemployment increase the tendencies already started by a shrinkage in the credit structure?

Are depressions acute?

Those who emphasize the acute nature of depressions would point to the peculiar circumstances preceding each major depression as a major cause of the recession in economic activity. Six major depressions since the Civil War may be noted. Certain it is that definite and peculiar circumstances accompanied each one. These may be tabulated as follows:

1.	1874–79	1873—Demonetization of silver. 1875—Specie Payment Act (effective 1879). 1878—Bland-Allison Act.
2.	1884–85	Collapse of R.R. speculation.
3.	1893–98	Agricultural depression. Silver issue.
4.	1908	Stock market panic. International speculation.
5.	1914–15	Outbreak of World War.
6.	1920–22	Post-war deflation.

2. Can you think of any special circumstances that would explain the depression starting in 1929?

Are we at the end of an epoch?

The general breakdown of the economic order starting in 1929 has reached such marked proportions and such a degree of seriousness that some are inclined to believe that our whole economic system is outworn and that a new, or at least a modified, economic order is in the making. This may be termed the epochal viewpoint. In support of this contention it is claimed that economic depressions have constantly increased in severity as our institutions have become more

Another Depression Scene. A run on a bank.

highly developed and our economic life more and more intricate and interdependent. For example, the increased dependence upon a money income, the highly developed credit mechanism, the increased volume of international finance, the increasing interdependence within and among the great corporations, and combinations of corporations would all have to be numbered among the fundamental changes that may at this very moment be ushering in a new epoch. What the nature of this new epoch will be nobody can say. Change is inevitable in all social and economic life. Change may lead the way to progress or to retrogression. The result will de-

pend upon the ability of men and women now living to think through social and economic problems and their disposition and determination to act courageously and intelligently.

Filene Tells Cornell Students Pioneer Spirit Fails

ITHACA, N. Y., March 24 (AP).—The pioneer spirit, rugged Americanism and intensified nationalism were described in an address to Cornell students today by Edward A. Filene, of Boston, nationally known merchant and executive, as "worthless in a machine civilization." He spoke before students of the College of Engineering on "The Engineering Mind and the Second Industrial Revolution."

Declaring that "our world leaders cannot be statesmen and experts in independence," and that "they must be industrialists and experts in interdependence," he emphasized:

"During the last fifteen years we have had a great revival of nationalism. In almost every country on earth, including our own, the cry has gone up that the nation must achieve independence, become self-supporting, self-sufficient and able to manage its own affairs, regardless of what may happen to the rest of the world." This he termed "propaganda" based upon fallacy.

He described the "second industrial revolution" as a "machine civilization in which any job, if it is to be profitable and lasting, must serve the general good."

CASE 113

New York Herald Tribune.

3. Refer to Case 113. Discuss Mr. Filene's viewpoint with particular reference to:
(a) poverty being unnecessary,
(b) increased interdependence,
(c) leadership based on fact-finding.

Conclusions.

A. What does the history of economic life show so far as business depressions are concerned?

1. What arguments may be advanced to show that depressions are chronic?
   (a) What periods common to all depressions may be noted?
2. What arguments may be advanced to show that depressions are caused by specific events?
   (a) Mention outstanding events in American history that have apparently contributed to periods of depression.

3. What reason have we to believe that we are entering a new epoch in the matter of economic relationships?
   (a) What important tendencies are apparently the cause of the change?

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